Supreme Court, U.S.
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No.

In the Supreme Court of the United States

OCTOBER TERM, 1994

UNITED STATES OF AMERICA, PETITIONER

v.

XEROX CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

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QUESTIONS PRESENTED

1. Whether Article 23(1) of the tax treaty between the United States and the United Kingdom [1] requires the United States to allow respondent a foreign tax credit in 1974 for the "advance corporation tax" that its United Kingdom subsidiary paid in that year to the United Kingdom government when, in a later year, the subsidiary "surrendered" that tax payment, under applicable United Kingdom law, to its own United Kingdom subsidiaries for application against the United Kingdom corporation tax liabilities of those subsidiaries.

2. Whether affidavits offered by respondent five years after the trial of this case—containing the proffered, unexamined recollections of several individuals who were not current officials and were not authorized to speak on behalf of any government—may be considered as part of the evidentiary "record" of this case in evaluating the intent and course of dealing of the treaty signatories.

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[1] The full name of the treaty is the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains. It is reported at T.I.A.S. No. 9682, 31 U.S.T. 5668.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-32a) is reported at 41 F.3d 647. The opinion of the Claims Court (now the Court of Federal Claims) (App., *infra*, 35a-72a) is reported at 14 Cl. Ct. 455.

JURISDICTION

The judgment of the court of appeals was entered on December 6, 1994. A petition for rehearing was denied

on February 7, 1995 (App., *infra*, 34a). On May 2, 1995, the Chief Justice extended the time for filing a petition for a writ of certiorari to and including June 7, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY, TREATY AND REGULATORY PROVISIONS INVOLVED

The pertinent parts of (i) Sections 901, 902 and 905(c) of the Internal Revenue Code as in effect for 1974 (26 U.S.C. 901, 902, 905(c)), (ii) Articles 2(2), 10(2) and 23(1) of the income tax treaty between the United States and the United Kingdom, (iii) the Technical Explanation of the Treaty submitted by the Treasury to Congress, 1980-1 C.B. 455, and (iv) Revenue Procedure 80-18, 1980-1 C.B. 623, are set forth in the Appendix, *infra*, 75-83a.

STATEMENT

1. A United Kingdom corporation is required to pay a "corporation tax" on its net profits (App., *infra*, 39a). That tax is analogous to our own corporate income tax. In the Finance Act of 1972, the United Kingdom also required its corporations to pay an "advance corporation tax" (ACT), the liability for which generally arises when a corporation pays a dividend (*ibid.*). As in effect in 1974, the Finance Act of 1972 imposed the "advance corporation tax" at a rate of three-sevenths of the amount of the dividend (*id.* at 40a).[2] A dividend payment of £ 70 would thus give rise to a liability of £ 30 of "advance corporation tax."

A United Kingdom corporation may apply its "advance corporation tax" payments to satisfy its underlying "cor-

[2] The United Kingdom "advance corporation tax" has been modified several times since it was enacted in 1972. The basic structure remains intact, however, and the issues raised in this case with respect to 1974 continue to be relevant today.

poration tax" liability (App., *infra*, 40a-41a). Any "advance corporation tax" payment that is not used to satisfy the corporation tax due for the current year may be carried back two years, or carried forward indefinitely, for application against corporation tax liability in other years (*ibid.*). Instead of applying its "advance corporation tax" payments to satisfy its own corporation tax liability, a United Kingdom corporation may "surrender" that right to one or more of its United Kingdom subsidiaries, for application against the corporation tax liabilities of those subsidiaries (*id.* at 41a).

Under the Finance Act of 1972, an individual United Kingdom resident shareholder who receives a dividend from a United Kingdom corporation is required to include in his reported income the amount of the dividend *plus* the amount of the "advance corporation tax" imposed on the corporation with respect to the dividend (App., *infra*, 43a). The shareholder is then allowed a credit against his United Kingdom income tax liability for the amount of the "advance corporation tax" thus included in his income (*ibid.*). If that credit exceeds the shareholder's income tax liability, he is entitled to a refund of the excess amount (*ibid.*). The Finance Act of 1972 seeks in this manner to reduce (but not eliminate) the traditional "double tax" on corporate income that arises when shareholders are taxed on dividends paid out of previously taxed corporate income (*id.* at 5a).

When the Finance Act of 1972 was originally enacted, only the shareholders of United Kingdom corporations who were United Kingdom residents were entitled to a credit against United Kingdom taxes for the "advance corporation tax" paid in connection with the dividends distributed to them. Non-resident shareholders were not provided such a credit (App., *infra*, 44a).

2. Following enactment of the Finance Act of 1972, the United States and the United Kingdom negotiated a new income tax treaty. As is relevant to this case, the

new treaty addressed two principal concerns: (i) whether the United States would recognize the "advance corporation tax" as a foreign "income" tax for the purpose of allowing a tax credit under 26 U.S.C. 902 to a United States corporation whose United Kingdom subsidiary has paid the advance tax;[3] and (ii) the extent to which United States shareholders of United Kingdom corporations are to obtain a benefit parallel to the tax credit that the United Kingdom provides its own residents with respect to dividends upon which the "advance corporation tax" has been paid.

The new income tax treaty between the United States and the United Kingdom was signed on December 31, 1975. The Treaty entered into force on April 25, 1980. 31 U.S.T. at 5668; see note 1, *supra*. Two articles of the Treaty are relevant to this case.

First, under Article 10(2)(a)(i), when a United Kingdom subsidiary pays a dividend to its United States corporate parent, the United Kingdom government is to pay the United States parent an amount equal to one-half of the tax credit (the amount of the "advance corporation tax") to which an individual resident of the United Kingdom would have been entitled had he received the same dividend (App., *infra*, 45a-46a).[4]

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[3] Under 26 U.S.C. 902, a United States corporation is granted a tax credit against its United States income tax liability for the appropriate share of the "foreign income taxes" paid by its subsidiaries with respect to the income distributed as dividends by those subsidiaries to the United States corporation. See *United States* v. *Goodyear Tire & Rubber Co.*, 493 U.S. 132, 134-135 (1989). Prior to the adoption of the new tax treaty between the United States and the United Kingdom, the Treasury had expressed doubt as to whether the "advance corporation tax" imposed on dividends by the Finance Act of 1972 would qualify as an "income" tax for the purpose of 26 U.S.C. 902 (App., *infra*, 14a).

[4] The obligation of the United Kingdom to make payments under Article 10(2)(a)(i) became effective only for taxable years beginning after April 6, 1975 (App., *infra*, 48a). The United Kingdom was therefore not obligated to, and did not, make payments under

Second, Article 23(1) of the Treaty provides that, "[i]n accordance with the provisions and subject to the limitations of the law of the United States," the United States will allow a foreign tax credit for "the appropriate amount" of income taxes paid to the United Kingdom by a United Kingdom corporation with respect to the income from which that corporation pays dividends to a United States shareholder (App., *infra* 46a-47a). See note 3, *supra*. Under Articles 23(1)(a) and 23(1)(c), respectively, the United Kingdom "corporation tax" and "advance corporation tax" (to the extent that the latter is not refunded by the United Kingdom to the United States corporate shareholder pursuant to Article 10(2)(a)) are deemed "income" taxes for this purpose (App., *infra*, 46a-48a).

In a Technical Explanation submitted to the Senate in connection with hearings on ratification of the Treaty (1980-1 C.B. 455, 472; App., *infra*, 81a-82a), and in a revenue procedure issued on the date that the Treaty went into force (Rev. Proc. 80-18, 1980-1 C.B. 623, 625; App., *infra*, 82a-83a), the Treasury Department explained that (i) if the "advance corporation tax" payment is *not* applied against the "corporation tax" liability in the year the "advance" tax is paid, a foreign tax credit will be allowed provisionally for the "advance" tax paid in that year but (ii) when that payment is subsequently applied against "corporation tax" (or is "surrendered" to a subsidiary for application against "corporation tax") in a different year, the initial credit will be reversed under

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Article 10(2)(a)(i) with regard to the dividends and related "advance corporation tax" payments at issue in this case, which were made in 1974 (App., *infra*, 48a).

A payment by the United Kingdom government to the United States corporate shareholder of one-half of the credit made available to the United Kingdom resident shareholder was viewed as sufficient to place United States investors on a par with United Kingdom resident shareholders. Statement of Ass't Sec'y Woodworth, 1980-1 C.B. 433, 436 (July 19, 1977).

26 U.S.C. 905(c) and a permanent credit will be allowable instead in the year that the offset is actually made.[5]

3. In 1974, Rank Xerox, Ltd. (RXL), respondent's United Kingdom subsidiary, paid respondent a dividend of £ 9.2 million and paid an "advance corporation tax" of £ 3.9 million on that dividend. RXL applied 26.5 percent of that "advance corporation tax" payment toward its "corporation tax" liability for 1974. RXL "surrendered" the right to set off the remaining 73.5 per-

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[5] When a United Kingdom subsidiary pays a dividend to its United States parent and pays the "advance corporation tax" to the United Kingdom government on that dividend, the United States parent is entitled to a "foreign income tax" credit—to the extent permitted under United States law—by virtue of Article 23(1)(c) of the Treaty (App., *infra*, 80a-81a). If the United Kingdom subsidiary makes an advance tax payment in one year but applies that payment to satisfy its corporation tax for a *subsequent* year, that deferred application of the advance payment constitutes an "adjustment" or "refund" of the tax for the year paid. In that situation, the provisional credit for the year that the "advance corporation tax" was paid is reversed under the applicable provisions of United States law (26 U.S.C. 905(c)), and a permanent credit is then allowable for the year in which the "advance corporation tax" is actually applied against the "corporation tax" liability of the corporation (App., *infra*, 55a). This conclusion follows from 26 U.S.C. 905(c), which provides that "[i]f accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the * * * Secretary * * * shall redetermine the amount of the tax for the year or years affected." See also pages 17-21, *infra*.

Similarly, if the United Kingdom subsidiary surrenders its "advance corporation tax" to a second-tier subsidiary, then the provisional credit allowed to the corporation that paid the advance tax is reversed and the advance tax is allowable as a credit in the year it is applied against the "corporation tax" liability of the second-tier subsidiary. In that situation, under 26 U.S.C. 902(b), the foreign tax credit flows through to the United States parent only if and when the second-tier subsidiary pays a dividend to its United Kingdom parent out of the profits to which the advance tax payment was applied and the first-tier subsidiary, in turn, pays a dividend to the United States parent. See 26 U.S.C. 902(a) and (b)(1).

cent of its "advance" tax payment to three of its United Kingdom subsidiaries, for use against their "corporation tax" liabilities in other years. Under Article 23(1)(c) of the Treaty, respondent claimed a foreign tax credit for 1974 for the entire £ 3.9 million of "advance corporation tax" that RXL paid to the United Kingdom in that year.[6]

Relying on the Technical Explanation of the Treaty, the implementing revenue procedure (Rev. Proc. 80-18) and 26 U.S.C. 905(c), the United States took the position that respondent was not entitled to a foreign tax credit in 1974 for the portion of the "advance corporation tax" that RXL surrendered to its subsidiaries. See note 5, *supra*. When the government did not grant respondent's refund claim for 1974, respondent commenced this refund suit in the Claims Court.

4. The Claims Court agreed with the government's interpretation of the Treaty. The court concluded that the Treasury's Technical Explanation and the implementing revenue procedure were consistent with the language of the Treaty and that "the meaning attributed to treaty provisions by the Government agencies charged with their negotiation and enforcement is entitled to great weight" (App., *infra*, 55a-56a, quoting *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. 176, 184 (1982)).

The Claims Court also relied upon the Competent Authority Agreement made between the governments of the United States and the United Kingdom in 1986, under which the Treaty parties agreed that "the timing of the credit is to be determined as a matter of U.S. law" (App., *infra*, 61a).[7] The court stated (*id.* at 63a):

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[6] Although the Treaty did not enter into force until April 25, 1980, Article 23 was made effective retroactively for taxes paid to the United Kingdom after April 1, 1973 (App., *infra*, 48a).

[7] Article 25(3) of the Treaty provides that "[t]he competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention." 31 U.S.T. 5688.

> the agreement of the competent authorities as to the governance of U.S. law over the timing of the Article 23(1)(c) credit accords with [the view of the United States], previously expressed in the Technical Explanation and Rev. Proc. 80-18, that the credit must ultimately be applied in the year the underlying ["advance corporation tax"] is used to offset U.K. corporation tax liability.

The court rejected respondent's assertion that these statements of the Treaty parties have no bearing on the proper interpretation of the Treaty (App., *infra*, 64a-65a):

> The court * * * does not share plaintiff's dim view of these documents. As previously discussed, Treasury's Technical Explanation was presented to the U.S. Senate as an aid to its understanding of the treaty articles, and the Senate's intent in ratifying the [Treaty] was clearly shaped thereby. In view of the United Kingdom's subsequent ratification of the [Treaty] without reservation, and with full knowledge of the Technical Explanation underlying the U.S. ratification, it is difficult to sustain plaintiff's assertion that the Technical Explanation did not conform with the terms of the treaty. Moreover, plaintiff can hardly minimize the importance of the Competent Authority Agreement as an expression of the intent of the treaty parties, since Article 25(3) of the [Treaty] specifically empowered the competent authorities "to resolve . . . any difficulties arising as to the interpretation or application of the Convention." Courts have traditionally been reluctant to impinge on the judgments of competent authorities charged by the treaty states with responsibilities of interpretation and implementation. *Sumitomo Shoji American, Inc. v. Avagliano*, 457 U.S. [at 185].

The court found nothing in the language of the Treaty or in its history to suggest that a result different from that described in the Technical Explanation and in the imple-

menting revenue procedure was intended by the parties to the Treaty (App., *infra*, 65a).

The court also observed that the Treasury's interpretation addresses the potential anomaly—and double tax credit—that could arise from an unthinking application of the Treaty language (App., *infra*, 67a). The court noted that, because Articles 23(1)(a) and 23(1)(c) treat both the "corporation tax" and the "advance corporation tax" as "income" taxes for purposes of the foreign tax credit under United States law (see note 3, *supra*, and note 12, *infra*), the Treaty language necessarily should be understood to permit the credit only when the latter is applied toward payment of the former. As the court observed, a double credit for the same economic tax would result if, as respondent contends, the "advance corporation tax" and the "corporation tax" were viewed simply as separate, independent events (App., *infra*, 67a). The court emphasized that such a double credit for the same economic tax would conflict with "the body of U.S. law holding that double crediting is to be avoided unless expressly anticipated or provided for by Congress" (*ibid.*, citing, *e.g.*, *Cleveland Electric Illuminating Co.* v. *United States*, 6 Cl. Ct. 711, 715 (1984)).

The Claims Court noted that respondent had introduced evidence at trial from two former government officials who expressed "their views as to the intent of the U.S. and U.K. treaty negotiators in 1975" (App., *infra*, 70a). The court stated that such evidence was entitled "to little evidentiary weight in this action" (*id.* at 71a), for the "statements of former U.S. government agents involved in the negotiations * * * cannot * * * take precedence over the Technical Explanation and other official pronouncements of the United States and the United Kingdom as evidence of the intent of the treaty parties" (*ibid.*).[8]

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[8] The court similarly concluded that internal agency memoranda relating to the preparation of the Technical Explanation and Rev.

5. The Claims Court entered its decision following the conclusion of the trial in this case in 1987. Other issues remained for disposition, however, and the court did not enter its final judgment until 1992. When the final judgment was entered, Xerox moved for reconsideration and for a new trial. In support of its motion, respondent submitted four new affidavits from former officials of the United States and the United Kingdom. In respondent's view, these affidavits supported the following propositions: (i) contrary to the court's conclusion, the United Kingdom was not aware of the Technical Explanation at the time the Treaty was ratified and (ii) the United States had "misrepresented" the truth in contending to the contrary.

In response to this motion, the United States stated that the unexamined affidavits of these former officials, submitted five years after the conclusion of the trial, were entitled to no weight. The government pointed out that the record developed at trial included (i) the contemporaneous transcripts of the Senate hearings, at which representatives of the Joint Committee on Taxation stated that "[i]t is our understanding that the basic treatment provided in the technical explanation was specifically part of the negotiated agreement with the United Kingdom" (*Tax Treaties With the United Kingdom, the Republic of Korea, and the Republic of the Phillipines: Hearings Before the Senate Comm. on Foreign Relations*, 95th Cong., 1st Sess. 50 (1977)) and (ii) other contemporaneous public records indicating the substantial degree of communication between the two governments concerning the meaning and application of the Treaty (including, of

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Proc. 80-18 were of little weight. The court explained that such internal memoranda can "not be accorded greater weight than the official U.S. government pronouncements which were issued thereafter" (App., *infra*, 71a).

course, the Competent Authority Agreement on which the Claims Court had relied at trial).[9]

The Claims Court denied respondent's motion. The court stated that the evidence belatedly offered by respondent provides "no grounds upon which to grant the motion" and that the "court stands by its Opinion issued over 4 years ago" (App., *infra*, 73a-74a).

6. The court of appeals reversed (App., *infra*, 1a-32a). The court stated that the "plain meaning of the Treaty" requires that a credit be given contemporaneously with the payment of the "advance corporation tax" because, in Article 23(1)(c) of the Treaty, the United States undertook to treat the "advance corporation tax" as a separate foreign "income" tax for purposes of United States law (*id.* at 12a, 31a). For that reason, the court said, the "advance corporation tax" is creditable in the year paid, and the subsequent application of the advance tax to the "corporation tax" has no effect on the proper timing of the tax credit (*id.* at 31a-32a).

The court acknowledged that the Treaty specifies that allowance of the credit for foreign taxes is to be "[i]n accordance with the provisions and subject to the limitations of the law of the United States" (App., *infra*, 8a). The court noted, however, that the Treaty does not expressly specify that there is to be an adjustment of the United States tax credit to the year that the advance tax is actually applied against the "corporation tax" obligation of the United Kingdom corporation (*id.* at 12a). The court stated that the official interpretation of the Treasury set forth in the Technical Explanation and the

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[9] In response to the claim of "misrepresentation," the government also noted that respondent had adduced evidence at trial showing that representatives of the United Kingdom and the United States had communicated concerning the provisions of the Technical Explanation before the Treaty was ratified by either party. See App., *infra*, 57a.

implementing revenue procedure thus lacks direct support in the language of the Treaty (*id.* at 20a, 22a).

Relying extensively on the post-trial affidavits submitted by respondent, the court further stated that the Treaty negotiators had not contemplated that the credit for payments of "advance corporation tax" would be aligned with the period in which the advance tax was applied against the "corporation tax" of the United Kingdom corporation.[10] Based on these same post-trial affidavits, the court further stated that the United Kingdom had not acquiesced in the views of the Treaty set forth in the Technical Explanation and the implementing revenue pro-

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[10] The court pointed to the affidavit of a former United States official who was involved in the Treaty negotiations for the proposition that aligning the credit for the "advance corporation tax" with the year in which that advance tax is applied against the "corporation tax" liability of the United Kingdom corporation "has never previously been set forth by the United States, the United Kingdom, or anyone else" (App., *infra*, 15a). That statement is difficult to reconcile with the fact that (i) the Technical Explanation prepared by the Treasury Department in 1977 and Rev. Proc. 80-18 prepared by the IRS in 1980 contained precisely that interpretation of the Treaty and (ii) the Technical Explanation was submitted to the Senate in connection with its treaty ratification hearings and the Revenue Procedure was submitted to the United Kingdom in connection with the Competent Authority Agreement on which the Claims Court relied (App., *infra*, 55a-58a). It is similarly difficult to understand the post-trial affidavit of Mr. Oosterhuis, formerly of the Joint Committee on Taxation, who averred that "the Treasury Department never presented to the Senate in its ratification procedure any explanation that the ["advance corporation tax"] is * * * an interim credit" (*id.* at 15a). Since the Technical Explanation was submitted by the Treasury "in connection with the Senate ratification proceedings" (*id.* at 17a), and since that document explained that the "advance corporation tax" is to be attributed to the year that it is applied to satisfy the "corporation tax" liability of the United Kingdom corporation (*id.* at 18a), the post-trial affidavit of Mr. Oosterhuis conflicts with the historical, public record.

cedure.[11] Noting that "[a] treaty must be construed in accordance with the intent of both signatories," the court stated that the post-trial affidavits reflect that the United Kingdom "did not accept, or even know of, the position taken in the Technical Explanation" (App., *infra*, 20a). Referring to the post-trial affidavits in describing what the court stated was an "extremely one-sided record," the court concluded that there was no "mutual assent by the signatories to the position taken by the Treasury" (*id.* at 21a).

The court of appeals dismissed the Competent Authority Agreement on which the Claims Court relied. The court acknowledged that this agreement was an authoritative elaboration of the Treaty (see note 7, *supra*). The court also acknowledged that the Competent Authority Agreement, which stipulates that "the timing of the credit is to be determined as a matter of U.S. law" (App., *infra*, 25a), was reached in response to the very questions raised in this litigation (*id.* at 24a). The court stated, however, that the Competent Authority Agreement is irrelevant to this case because the implementing revenue procedure and the Technical Explanation do not represent a "law" of the United States (*id.* at 25a-26a).

Turning finally to the applicable provisions of the Internal Revenue Code, the court ruled that Section 905(c) of the Code has no application to the timing of the tax credit involved in this case. Even though that Section

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[11] The unexamined affidavits of two former members of the United Kingdom parliament were relied on by the court of appeals as demonstrating a lack of awareness by the United Kingdom government as a whole of the interpretation of the Treaty evidenced in the Technical Explanation and the implementing revenue procedure. Those former officers, however, were not authorized to, and did not purport to, speak on behalf of the United Kingdom government. Moreover, their proffered testimony, like that of the other post-trial affiants, was not part of the trial record and was not subject to examination by the parties.

authorizes a "recalculation of the tax credit if the amount of foreign tax is refunded or adjusted after the credit is taken" (App., *infra*, 30a), the court stated that the payment of "advance corporation tax" is permanently fixed "when the dividends were paid" and that the subsequent application of that advance payment to the "corporation tax" owed in a different year does not represent a "refund" or "adjustment" of the tax (*id.* at 31a). In the court's view, "no adjustment of the * * * United States tax credit is [therefore] warranted" under Section 905(c) (App., *infra*, 31a).

REASONS FOR GRANTING THE PETITION

This case presents two related questions of substantial administrative importance. The first concerns the proper interpretation of the substantive provisions of the income tax treaty of the United States and the United Kingdom. In particular, it concerns whether respondent is entitled to a tax credit under United States law for the "advance corporation tax" paid by its United Kingdom subsidiary and then transferred (or "surrendered") by that subsidiary to its second-tier United Kingdom subsidiaries for subsequent application against the corporation tax owed by those subsidiaries. For the reasons that we will describe, the correct disposition of this substantive question has a significant impact on the public fisc.

The second, related question presented in this case concerns the proper evidentiary procedures to be followed in determining the intent and course of dealings of the Treaty signatories. The approach followed by the court of appeals—permitting post-trial affidavits of former government officials to be considered as part of the evidentiary "record" for this purpose—finds no sanction in the decisions of this Court and is at variance with standard notions of proof. In addition to the fact that such unexamined "evidence" is not admissible for this purpose, its use

would interfere with the proper functioning of treaty relations and would be an irritant in the administration of treaty affairs.

The Federal Circuit's decision was issued by a court of nationwide jurisdiction. Since all taxpayers are entitled to pay a challenged tax and sue for a refund within the Federal Circuit, and since the corporate taxpayers that are affected by the decision in this case are professionally counseled, it is unlikely that other courts of appeals will have an opportunity to review this same issue. In similar circumstances, this Court has recognized the need for plenary review of Federal Circuit decisions that present isues of substantial fiscal and administrative importance. See, *e.g.*, *United States* v. *Hill*, 113 S. Ct. 941, 945 (1993); *United States* v. *Goodyear Tire & Rubber Co.*, 493 U.S. 132, 138 (1989); *United States* v. *American Bar Endowment*, 477 U.S. 105, 109 (1986). Such review is appropriate in this case.

1. The court of appeals erroneously held that Article 23(1)(c) of the Treaty allows a foreign tax credit under United States law for the "advance corporation tax" paid by a United Kingdom subsidiary of a United States corporation without regard to when (or whether) that payment is in fact applied to the "corporation tax" liability of the subsidiary.

a. Articles 23(1)(a) and 23(1)(c) of the Treaty contain a potential anomaly. They provide that both the "corporation tax" and the "advance corporation tax" are to be recognized as a foreign "income" tax for purposes of the foreign tax credit provisions of United States law.[12]

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[12] Article 23(1)(a) of the Treaty specifies that the taxes listed in Articles 2(2)(b) and 2(3) of the Treaty—which include the "corporation tax"—"shall be considered to be income taxes" (App., *infra*, 79a, 81a).

Article 23(1)(c) provides that the portion of the United Kingdom shareholder credit that is not refunded to the United States corporate shareholder pursuant to Article 10(2)(a) shall be deemed

Under United Kingdom law, however, the "advance corporation tax" may be applied to satisfy the "corporation tax" liability. Unless the Treaty is to be assumed to have intended a double credit for the same economic tax—an assumption that no one contends should be made—then *some* mechanism must exist to determine whether the payment of the "advance" tax or of the "corporation tax" itself is controlling for purposes of the United States foreign tax credit.[13]

The opening paragraph of Article 23(1) of the Treaty indicates that the determination of *which* tax event is controlling for this purpose is to be made "[i]n accordance with the provisions * * * of the law of the United States" (App., *infra*, 80a). The Treaty signatories confirmed that conclusion through adoption of the Competent Authority Agreement in 1986. That agreement, which was adopted in response to the issues framed by this litigation, specifies that "Article 23(1) of the [Treaty] was not intended to provide two U.S. foreign tax credits for a single payment of ['advance corporation tax'] to the United Kingdom" and that "the timing of the credit is to be determined as a matter of U.S. law" (*id.* at 61a). As the Claims Court correctly stated, courts should defer to the bilateral understanding reached by the "competent authorities charged by the treaty states with responsibilities of interpretation and implementation" (*id.* at 65a, citing

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an income tax imposed on the United Kingdom corporation paying the dividend (App., *infra*, 81a). The United Kingdom shareholder credit is equal to the amount of "advance corporation tax" imposed on the United Kingdom corporation paying the dividend (*id.* at 43a).

[13] In concluding that the "advance corporation tax" must be treated as a "separate" tax from the "corporation tax" (App., *infra*, 31a), the court of appeals discounted the anomaly created by its interpretation of the Treaty language simply by stating that respondent had not "received" or "claim[ed]" that it was entitled to a double credit (*id.* at 26a).

Sumitomo Shoji America, Inc. v. *Avagliano*, 457 U.S. 176, 185 (1982)).

b. It is thus to United States law, not to the Treaty itself, that we are to look to determine the proper timing of this tax credit.

Section 901 of the Internal Revenue Code allows a United States corporation a credit for specified taxes that it has paid, or is deemed to have paid, to a foreign government. 26 U.S.C. 901(a). Under Section 902(a), a United States parent that receives a dividend from its foreign subsidiary is "deemed" to have paid a portion of the "foreign income taxes" that the subsidiary paid on the profits from which the dividend was distributed. 26 U.S.C. 902(a). See *United States* v. *Goodyear Tire & Rubber Co.*, 493 U.S. at 135.[14] Under Section 905(c), when a "foreign income tax" paid by the foreign subsidiary results in a foreign tax credit for its United States parent under Section 902, and the foreign tax of the subsidiary is thereafter adjusted or refunded, the United States income tax liability of the parent is to be redetermined. 26 U.S.C. 905(c). Section 905(c) thus provides a mechanism for final adjustment of the foreign tax credit at the time that the taxpayer ascertains and satisfies the exact amount of its foreign tax liability. See *Pacific Metals Corp.* v. *Commissioner*, 1 T.C. 1028, 1029 (1943) (interpreting Section 131(c) of the Internal Revenue Code of 1939, the predecessor to Section 905(c)).

In the Technical Explanation submitted to the Senate in connection with the Treaty ratification hearings, and in the implementing Rev. Proc. 80-18 issued on the date

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[14] The foreign tax credit provisions seek to eliminate a double taxation of foreign source income by the foreign country (on the income of the foreign subsidiary) and the United States (on the distribution of that income as a dividend). See B. Bittker & J. Eustice, *Federal Income Taxation of Corporations and Shareholders* ¶ 17.11 (5th ed. 1987).

that the Treaty went into force, the Treasury set forth its interpretation of the proper application of Section 905(c) in this unique, foreign tax setting. The Technical Explanation specified that a payment of "advance corporation tax" that is not contemporaneously applied to satisfy the "corporation tax" "will generally be attributed to the accumulated profits of the year of distribution." 1980-1 C.B. 455, 472-473. A United States foreign tax credit would therefore be allowed initially in the year the "advance corporation tax" is paid. But, if that payment is later applied to satisfy a "corporation tax" due in a different year, it "will be attributed to the earnings of the year in which it offsets such tax and treated as if it were regular corporate tax."[15] *Id.* at 472. When the "advance" tax is thus used to satisfy the "corporation tax" in a different year (*id.* at 473):

> the offset will be viewed as a refund of the ["advance" tax] initially allowed as a credit and as a tax paid in respect of the year for which the ["advance" tax] is applied as an offset. Consequently, a reduction in the foreign tax credit for the year

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[15] The Technical Explanation in this manner sought to implement the "matching principle" of the United States foreign tax credit system in the context where an "advance corporation tax" and a "corporation tax" are separately assessed. A fundamental principle of the United States foreign tax credit is that foreign income taxes are to be associated with the earnings on which they are imposed. "It is of critical importance to determine the 'accumulated profits' of each year, so that they can be matched against the foreign taxes paid for *that* year, and so that when dividends are paid 'out of' or 'from' such 'accumulated profits,' a foreign tax credit may properly be computed as a portion (in accordance with the statutory formula) of the foreign taxes paid in respect of the 'accumulated profits' of *that* year." *H.H. Robertson Co.* v. *Commissioner*, 59 T.C. 53, 79 (1972), aff'd per curiam, 500 F.2d 1399 (3d Cir. 1974). See *United States* v. *Goodyear Tire & Rubber Co.*, 493 U.S. at 138-139. The aim is to ensure that a foreign tax credit is allowed only for foreign income taxes paid on accumulated profits that are distributed to a United States taxpayer.

> from which the ["advance" tax] is carried must be made in accordance with section 905(c) of the Code.

Rev. Proc. 80-18 reached the same conclusion, and specified the same treatment, when the "advance" tax is transferred to a second-tier foreign subsidiary for application against the "corporation tax" liability of that subsidiary. 1980-1 C.B. at 625. In these published interpretations, the Treasury thus resolved the potential "double credit" anomaly created by Articles 23(1)(a) and 23(1)(c) by specifying that the foreign tax credit is finally allowable in the year that the "advance" tax is in fact applied to satisfy the "corporation tax" liability.

The court of appeals rejected the interpretation set forth in the Technical Explanation, stating that it defeated the Treaty's "stated purpose of avoiding double taxation of the same profits" (App., *infra*, 20a). But the Technical Explanation does not result in double taxation. If "advance corporation tax" is not used to offset "corporation tax" in the current year, it effectively becomes an increased income tax on the profits from which the dividend is distributed. The Technical Explanation allows a foreign tax credit for the "advance" tax in that year, thereby ensuring that those profits are not taxed twice. But, when the "advance" tax payment is subsequently used to satisfy "corporation tax" due in another year, the Technical Explanation treats the "advance" tax as an income tax payment on the profits *only* of that other year (as specified under United Kingdom law by Section 92(6) of the Finance Act of 1972). It thereby ensures that the profits of that other year are not taxed twice.[16]

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[16] The suggestion of the court of appeals that the Senate "criticized" the Technical Explanation (App., *infra*, 18a) is not correct. The Senate Committee on Foreign Relations issued a report in connection with its ratification hearings that explicitly stated its intention to defer to the Treasury's Technical Explanation in con-

The Treasury's interpretation of the proper interplay between the provisions of this Treaty and of Section 905(c) of the Internal Revenue Code is entitled to substantial deference. The correct application of these unique United Kingdom tax concepts within the general terminology of the Internal Revenue Code provisions that provide a tax credit for "foreign income taxes" (26 U.S.C. 902(a)) involves precisely the type of interpretive issue for which deference to the Treasury is most appropriate.[17] The agency's interpretation, set forth in public

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nection with the precise issue raised in this case (S. Exec. Rep. No. 18, 95th Cong., 2d Sess. 36-37 (1978) (emphasis added)):

> The Treasury's technical explanation also sets forth a complex set of rules and examples intended to be used for purposes of determining the earnings to which ["advance corporation tax"] payments by a U.K. corporation are to be attributed for purposes of computing the indirect U.S. foreign tax credit. * * * These rules raise difficult and complex issues. In recommending the ratification of the proposed treaty, the Committee does not intend that these rules necessarily serve as a model for future treaties. Further, in recommending the ratification of the treaty, *the Committee does not intend to adopt or reject the amplifications of the foreign tax credit rules contained in the Treasury technical explanation. Consequently, Treasury would not be foreclosed by the ratification of the treaty from modifying those administrative interpretations in the future should it deem it advisable to do so.*

This passage from the Senate report, on which the court of appeals relied (App., *infra*, 19a), suggests only that the Senate did not intend to ossify the Treasury position by appearing to adopt it as substantive law. The Senate expressly did not "reject the amplifications of the foreign tax credit rules contained in the Treasury technical explanation."

[17] In the courts below, respondent claimed that the Treasury's interpretation was precluded by *Biddle* v. *Commissioner*, 302 U.S. 573 (1938), and *Helvering* v. *Queen Insurance Co.*, 115 F.2d 341 (2d Cir. 1940), cert. denied, 312 U.S. 706 (1941). But *Biddle* concerned whether the taxpayer had himself paid a foreign income tax on the earnings he received (302 U.S. at 583) and *Queen Insurance* concerned whether a *non*-income tax that is used to satisfy an "income" tax thereby becomes a creditable "income"

rulings issued contemporaneously with the signing and ratification of the Treaty, should not have been rejected by the court of appeals (*National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 477 (1979)):

> "Congress has delegated to the * * * Commissioner [of Internal Revenue], not to the courts, the task of prescribing 'all needful rules and regulations for the enforcement' of the Internal Revenue Code. 26 U.S.C. § 7805(a)." *United States* v. *Correll*, 389 U.S. at 307. That delegation helps ensure that in "this area of limitless factual variations," *ibid.*, like cases will be treated alike. It also helps guarantee that the rules will be written by "masters of the subject," *United States* v. *Moore*, 95 U.S. 760, 763 (1878), who will be responsible for putting the rules into effect.

c. The decision of the court of appeals threatens serious adverse consequences to the administration of the tax laws. The court discarded the carefully structured rules that the Treasury devised to integrate the Code and the Treaty and replaced those rules with a simplistic, "plain meaning" interpretation that fails to address—much less to resolve—the inherent "double credit" anomaly that the Treaty language contains. See note 13, *supra*.

The decision of the court of appeals is certain to have a significant effect on the public fisc. For 1990, the most recent year for which statistics are available, United

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tax under the Code (115 F.2d at 342). The present case, by contrast, involves application of the foreign income tax credit provisions of the Internal Revenue Code in a setting that, under the terms of the Treaty, provides *two* creditable foreign income taxes with respect to the same stream of earnings. Because foreign law permits the payment of one of those taxes to be applied toward satisfaction of the other, the Technical Explanation and the implementing revenue procedure address the problem of *which* payment controls the proper timing of the credit. Neither *Biddle* nor *Queens Insurance* governs, or provides instruction for resolution of, the interpretive issues addressed in this case.

States corporations reported more foreign-source income from the United Kingdom than from any other country.[18] The foreign tax credits claimed by United States taxpayers with respect to the "foreign income taxes" paid by their United Kingdom subsidiaries exceeded $2.24 billion.[19] Even a modest increase or realignment of foreign tax credits available to these United States taxpayers could yield huge revenue consequences.[20] Moreover, the statute of limitations for amended returns with respect to foreign tax credit claims is ten years from the date that the taxpayer's return was filed. 26 U.S.C. 6511(d)(3). The decision in this case thus threatens a major impact on revenue not only for the future, but also for a significant period into the past.

The revenue impact of the decision in this case is compounded by the fact that any taxpayer is free to pay the contested tax and sue for a refund within the Federal Circuit. Taxpayers obviously will find it in their interest to compute their foreign tax credits for "advance corporation tax" under both the approach adopted in the Technical Explanation and the approach adopted by the Federal Circuit and then obtain the more favorable tax treatment simply by electing their preferred judicial or administrative forum. Evenhanded enforcement of the foreign tax credit provisions would thus be fully compromised.

2. It is well established that "the meaning attributed to treaty provisions by the Government agencies charged with their negotiation and enforcement is entitled to great weight." *United States* v. *Stuart*, 489 U.S. 353, 369

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[18] Internal Revenue Service, *Statistics of Income Bulletin* 11 (Winter 1994-1995).

[19] Internal Revenue Service, *Statistics of Income Bulletin* 38 (Winter 1994-1995).

[20] For respondent alone, millions of dollars of tax savings are involved. See App., *infra*, 36a.

(1989), quoting *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 184-185. See also *Kolovrat* v. *Oregon*, 366 U.S. 187, 194 (1961). Instead of accepting the Treasury's interpretation of the Treaty, as confirmed by the Competent Authority Agreement (App., *infra*, 23a-26a), the court of appeals relied heavily upon post-trial affidavits submitted (i) by former United States and United Kingdom officials who stated that Article 23(1) was not described during negotiations as providing an "interim" credit for "advance corporation tax" (App., *infra*, 14a-16a; see note 10, *supra*) and (ii) by former United Kingdom officials who stated that they were unaware of the Treasury's Technical Explanation and did not acquiesce in it (App., *infra*, 20a-21a).

The court of appeals erred in extensively quoting and relying on those unexamined post-trial affidavits in evaluating the intent and course of dealing of the Treaty parties. The court further erred in stating that these affidavits form part of the evidentiary "record" of this case (App., *infra*, 21a).

a. Even if these affidavits were a valid part of the evidentiary record of this case, they would not alter the conclusion that the timing of the credit is not resolved under the Treaty but is to be resolved as a matter of United States law. Under the Treaty, the United States agreed that the "corporation tax" and the "advance corporation tax" represented a "foreign income tax" for the purposes of the foreign tax credit available under United States law (26 U.S.C. 902). The parties explicitly agreed in Article 23(1) of the Treaty that the credit for those taxes would be allowed "[i]n accordance with the provisions and subject to the limitations of the law of the United States" (App., *infra*, 80a). And, in the Competent Authority Agreement, the Treaty parties agreed that a double credit was not intended for the two taxes and that "the timing of the credit [for the "advance cor-

poration tax"] is to be determined as a matter of U.S. law" (*id.* at 25a).[21]

When the question of the timing of the tax credit was thus explicitly addressed by the Treaty parties, they agreed that United States law, rather than the Treaty itself, is controlling. This rational interpretation of the Treaty by the competent authorities is "entitled to great weight." *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 185. The court of appeals should have deferred to that interpretation. *Ibid.* See also *Kolovrat* v. *Oregon*, 366 U.S. at 194; *Factor* v. *Laubenheimer*, 290 U.S. 276, 298 (1933); *Charlton* v. *Kelly*, 229 U.S. 447, 473 (1913); *Whitney* v. *Robertson*, 124 U.S. 190, 194-195 (1888).

b. Moreover, the court of appeals committed two important evidentiary errors in treating the unexamined, post-trial affidavits of former government officials as part of the "record" of this case.

(i) Even if the testimony of such individuals had properly been offered at trial, it would have been entitled to no weight.[22] This Court has recognized that the contemporaneous records of treaty negotiations and the public records of the parties' official course of dealings under

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[21] The trial record of this case contained additional contemporaneous evidence from the public record that indicated that—long before adoption of the Competent Authority Agreement—the United Kingdom had notice of the Technical Explanation and made no objection to it. See note 10, *supra*. The United Kingdom also unquestionably had notice of the interpretation set forth in Rev. Proc. 80-18 before the Competent Authority Agreement was signed in 1986 (App., *infra*, 24a).

[22] The court of appeals erred in characterizing the two United Kingdom affiants as "negotiators" (App., *infra*, 15a). They were not. Their affidavits show that they were members of Parliament. Neither affiant states that he was a negotiator or direct participant in the Treaty negotiations. Nor does either affiant state that he has authority to speak on behalf of the United Kingdom government.

a treaty have an appropriate role in ascertaining the meaning of treaty language. Drafts of the treaty, official government interpretations of treaty language and competent authority agreements are all relevant, in proper circumstances, in determining the correct application of treaty provisions. See, *e.g.*, *Air France* v. *Saks*, 470 U.S. 392, 398-405 (1985); *Factor* v. *Laubenheimer*, 290 U.S. at 294-295.

But the post-treaty recollections of individual, former government employees—who are *not* "competent authorities" to interpret the Treaty—are entitled to no weight. In an analogous context, this Court has discounted the relevance of post-enactment testimony of Senators or Representatives concerning their understanding of legislative language or history. See, *e.g.*, *Weinberger* v. *Rossi*, 456 U.S. 25, 35 (1982); *United States* v. *United Mine Workers*, 330 U.S. 258, 281-282 (1947). The post-treaty testimony of former government employees, who are not speaking as "competent authorities" of the treaty governments, is similarly entitled to no weight in the interpretation of treaty provisions. As the Claims Court correctly stated in this case, the "statements of former U.S. government agents involved in the negotiations * * * cannot * * * take precedence over the Technical Explanation and other official pronouncements of the United States and the United Kingdom as evidence of the intent of the treaty parties" (App., *infra*, 71a). It is the latter, not the former, that this Court has stated is "entitled to great weight" (*Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 184-185).

(ii) Even if the recollections of former government agents were thought relevant to questions of treaty interpretation, the court of appeals erred in describing (and relying upon) the post-trial affidavits proffered by respondent as part of the evidentiary "record" of this case (App., *infra*, 21a). If such statements of personal recollection are relevant in a particular case, their proof should conform to normal evidentiary requirements. The

unexamined affidavits proffered by respondent, however, represent classic hearsay that would not have been admissible even if timely offered at trial. See, *e.g.*, Fed. R. Evid. 802; 5 J. Wigmore, *Evidence* § 1384, at 84 (Chadbourn ed. 1974) ("it is clear that a mere affidavit —i.e., a statement made upon oath before an officer— is inadmissible"). The "one-sided record" described by the court of appeals (App., *infra*, 21a) truly was "one-sided"; the Court has long stated that such ex parte affidavits are not proper evidence (*Walsh* v. *Rogers*, 54 U.S. (13 How.) 283, 287 (1851)): [23]

> [T]estimony thus taken is liable to great abuse. At best, it is calculated to elicit only such a partial statement of the truth as may have the effect of entire falsehood. The person who prepares the witness and

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[23] Affidavits are generally inadmissible to prove the truth of the matters asserted therein unless they (i) come within an exception to the hearsay rule or (ii) are offered in connection with an aspect of the proceeding for which hearsay may be considered. See 6 J. Wigmore, *supra*, §§ 1709-1710; 4 C. Mueller & L. Kirkpatrick, *Federal Evidence* § 432, at 357 & nn.7-9 (2d ed. 1994). The hearsay affidavits proffered by respondent, setting forth the individual recollections of former government agents (see Fed. R. Evid. 801(d)(2)(D)), would not come within either the "official record" or "state paper" exceptions (see *Vanadium Corp.* v. *Fidelity & Deposit Co.*, 159 F.2d 105, 109 (2d Cir. 1947)). Nor do they represent a record maintained in routine course of business (see *Palmer* v. *Hoffman*, 318 U.S. 109, 112 (1943)).

Affidavits may properly be employed in connection with certain motions, including a new trial motion based upon newly discovered evidence. See 4 C. Mueller, *supra*, § 432, at 357. When offered for that purpose, however, the affidavits would be relevant only for evaluation of the new trial motion and not for evaluation of the merits of the underlying decision. Respondent initially proffered the post-trial affidavits in this case in support of its new trial motion (App., *infra*, 73a-74a). On appeal, however, respondent addressed only the merits of the underlying decision and did not renew its request for a new trial. In reversing the trial court, the court of appeals erroneously treated these affidavits as if they were part of the substantive, evidentiary "record" of the case.

> examines him can generally have just so much or so little of the truth, or such a version of it, as will suit his case.

The court of appeals further erred in treating affidavits proffered five years *after* trial as part of the evidentiary "record" (App., *infra*, 21a). It is at trial, not on appeal, that evidence of individual recollections (if relevant) is ordinarily tested through methods such as cross-examination for bias and memory error. The course of treaty interpretation followed by the court of appeals, however, relies on affidavits presented *after* trial from individuals who have long been removed from the pertinent events and whose errors in recollection and interpretation cannot be exposed in examination.[24]

c. The evidentiary approach of the court of appeals threatens to create a persistent irritant in treaty administration. Instead of observing the appropriate deference owed to official interpretations of treaty language, the court of appeals looked to the unexamined recollections of former government agents concerning the intent and course of dealing of the treaty parties. The court, in this fashion, substituted the non-official, personal views of former officials for the official judgment of those who are the designated, "competent authorities" to interpret the Treaty.

The approach followed by the court of appeals would allow the recollections of individual employees, rather than the considered, public views of governments, to ad-

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[24] In *O'Connor* v. *United States*, 479 U.S. 27 (1986), the written, official views of the "competent authorities" were submitted after the conclusion of the trial and while the case was pending on appeal. The petitioner asserted that the "mutual agreement between the contracting parties on interpretation cannot be dispositive of third-party rights" and objected to the admissibility of the diplomatic note. Because the Court sustained "the Government's position without reference to the note," the Court concluded that it "need not resolve these disputes." *Id.* at 33 n.2.

just the affairs of Nations.[25] It would also encourage attempts by litigants to introduce such evidence. The potential mischief that could result from such a personalized approach to treaty interpretation—and the injury to the ability of governments to engage in the sensitive process of bilateral administration of treaty agreements—is obvious.

The evidentiary approach of the court of appeals creates uncertainty for the Departments that administer our Nation's treaty relations by threatening radically to alter the processes by which the treaties of the United States are interpreted. Guidance is needed concerning the extent to which the unofficial recollections of former employees are relevant and admissible in cases involving treaty construction. Further review is warranted for this reason alone, as well as for the reasons described above.

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[25] In cases such as *Eastern Airlines, Inc.* v. *Floyd*, 499 U.S. 530 (1991), the Court has looked to the official Minutes and other components of the "documentary record" of negotiations to determine the context and meaning of treaty language. See *id.* at 544, 547. See also *Air France* v. *Saks*, 470 U.S. at 402-403. In these cases, the Court did not rely on the subsequent recollections of individuals involved in the treaty process. No single individual would possess a comprehensive knowledge of the entire course of communications between the governments.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JUNE 1995

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

93-5094

XEROX CORPORATION, PLAINTIFF-APPELLANT

v.

THE UNITED STATES, DEFENDANT-APPELLEE

Decided: December 6, 1994

Before RICH, NEWMAN, and PLAGER, *Circuit Judges.*

NEWMAN, *Circuit Judge.*

This tax appeal has its origins in the United Kingdom system of corporate and shareholder taxation that was adopted in the Finance Act of 1972. The ensuing changes of tax structure in the United Kingdom resulted in renegotiation of the tax treaty between the United Kingdom and the United States, in order to obtain for United States shareholders the avoidance of double taxation on dividends. This benefit had been made available to United Kingdom

shareholders through a method of "imputation," enacted in the 1972 law.

The issue is whether Xerox Corporation is entitled, by virtue of the tax treaty, to an indirect foreign tax credit for tax year 1974 for certain Advance Corporation Tax ("ACT") that was paid in the United Kingdom by its affiliated company Rank Xerox Ltd. ("RXL"), on dividends that RXL paid to Xerox Corporation in 1974.

We conclude that the tax treaty and revenue code allow the tax credit to Xerox for the tax year in which the ACT was paid or accrued in the United Kingdom, whether or not the ACT was offset against mainstream corporation tax in the United Kingdom, or was otherwise used or surrendered by RXL in accordance with United Kingdom law.

BACKGROUND

Xerox, a New York corporation, owned directly and indirectly the majority of the voting shares of RXL, a corporation of the United Kingdom. RXL had various subsidiary companies in the United Kingdom, including Rank Xerox Management Limited, Rank Xerox U.K. Limited, and Rank Xerox Ireland Limited. In 1974, the tax year here at issue, RXL paid a dividend distribution to Xerox and paid the requisite ACT in the United Kingdom on the distribution.

A portion of that ACT was set off in 1974 against RXL's mainstream corporation tax in the United Kingdom, as permitted by British law; the foreign tax credit for that portion of the 1974 ACT is not in dispute. However, a portion of the ACT was not used to offset RXL's mainstream tax. In 1980 this

unused ACT was surrendered by RXL to its United Kingdom subsidiaries, again as permitted by British law. The United States Internal Revenue Service ("IRS") then withdrew the foreign tax credit for this portion of the ACT, credit that had been allowed to Xerox in 1974, and required payment of the corresponding income tax on the dividends received by Xerox in 1974. Xerox paid the tax and brought suit for refund in the Claims Court. Recovery was denied. *Xerox Corp. v. United States*, 14 Cl. Ct. 455 (1988).[1] Final Judgment was entered on Nov. 5, 1992. Xerox states that it has been allowed no foreign tax credit for this ACT, and that the same profits have thereby been taxed twice.

A. The United Kingdom Finance Act of 1972

The system of corporate taxation that was instituted by the United Kingdom Finance Act of 1972 was designed, *inter alia*, to eliminate double taxation of the same profits, at both the corporate and shareholder levels. This was achieved by "imputation" to resident shareholders of the tax paid by the corporation on distributions to the shareholders. In accordance with the Finance Act of 1972, a United Kingdom corporation must pay 1) mainstream corporation tax, which is a tax on corporate income, and 2) advance corporation tax (ACT), a tax on any qualifying distribution to shareholders. Section 85 of the Finance Act of 1972 provides that ACT payments can be used by a United Kingdom corporation to offset its mainstream corporation tax (the "Section 85 offset"). However, the ACT must be

[1] The Claims Court was renamed the Court of Federal Claims in 1992.

paid by the United Kingdom corporation when the shareholder distribution is made, regardless of the corporation's mainstream tax liability or offset opportunity.

The ACT is payable whether or not the corporation has any profits. ACT is not refundable, whether or not it is used as a Section 85 offset by the United Kingdom corporation that paid the tax.[2] Unused Section 85 offset can be carried back to the two preceding taxable periods or carried forward indefinitely.

Section 92 of the Finance Act of 1972 permits the distributing corporation that paid the ACT to surrender, at any time, all or part of its Section 85 offset to a United Kingdom subsidiary that is 51% or more owned by the distributing corporation. The subsidiary can then use the surrendered offset against its own mainstream corporation tax. The right to carry forward or surrender Section 85 offset to subsidiaries is useful, for example, when the United Kingdom parent corporation has excess foreign tax credits, because those credits must be used in the year they are earned.

Section 86 of the Finance Act of 1972 provides that a United Kingdom resident shareholder is entitled to a tax credit for the ACT paid by the corporation. This is called the "Section 86 credit":

> 86(1) [Entitlement to Credit] Where a company resident in the United Kingdom makes a qualifying distribution after 5th April 1973 and the person receiving the distribution is another

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[2] An exception can occur if the United Kingdom corporation pays ACT and then receives additional franked investment income during the same accounting period. That exception is not relevant to this case.

> such company or a resident in the United Kingdom, not being a company, the recipient of the distribution shall be entitled to a tax credit under this section . . . .
>
> 86(2) [Purpose and amount of tax credit] The tax credit in respect of a distribution shall be available for the purposes specified in the section and the subsequent provisions of this Act, and shall be equal to such proportion of the amount or value of the distribution as corresponds to the rate of advance corporation tax in force for the financial year in which the distribution is made.

In this way double taxation on dividends is alleviated for United Kingdom residents. The Section 86 credit can not be withdrawn or withheld by the United Kingdom tax authorities.

The resident shareholder receives the Section 86 credit when the dividend is received. However, the Finance Act of 1972 excluded non-resident shareholders from this benefit. In a document entitled *Reform of Corporation Tax Presented to the Parliament by the Chancellor of the Exchequer by Command of her Majesty*, April 1972, at p. 11 ¶ 32, it was stated that one of the reasons for denying non-resident shareholders the Section 86 credit was to require tax treaty partners to renegotiate the treaty terms, whereby the British government hoped to obtain balancing concessions.

B. The Renegotiated Tax Treaty

On enactment of the Finance Act of 1972, the United States requested renegotiation of the existing tax treaty. The purpose was to obtain the benefit of the shareholder tax credit for United States investors

who receive dividends from United Kingdom companies, thereby avoiding double taxation of the same profits. *See* S. Exec. Rep. No. 95-18, 95th Cong., 2nd Sess., 22-24, 32-37 (1978), *reprinted in* 1980-1 C.B. 411, 420-21, 426-29; Statement of Assistant Secretary of the Treasury Laurence N. Woodworth, July 19, 1977, before the Senate Foreign Relations Committee, *id.* at 86, 89-90, *reprinted in* 1980-1 C.B. at 433, 435-36.

The renegotiated tax treaty was signed on December 31, 1975, and amended by diplomatic notes on April 13, 1976, First Protocol of August 26, 1976, Second Protocol of March 31, 1977, and Third Protocol of March 15, 1979, together comprising the *Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains*, 31 U.S.T. 5668 (hereinafter the "Treaty"), *reprinted in* 1980-81 C.B. at 394. As was explained to the Senate during the ratification proceedings, Articles 10 and 23 of the Treaty were "designed to resolve the problems presented by the interaction of the U.S. system of corporate taxation and the new hybrid system adopted by the United Kingdom in 1973 [the Finance Act of 1972] which in part integrates corporate and shareholder taxation." S. Exec. Rep. No. 95-18 at 4, *reprinted in* 1980-81 C.B. at 413.

Treaty Article 10 is retroactive only to April 6, 1975, and thus does not apply to the ACT paid on Xerox's 1974 dividends. However, it is a guide to the purpose of the Treaty and the intent of its terms. The relevant portion is:

Article 10—Dividends

* * *

(2)(a) In the case of dividends paid by a corporation which is a resident of the United Kingdom:

(i) to a United States corporation which either alone or together with one or more associated corporations controls, directly or indirectly, at least 10 percent of the voting stock of the corporation which is a resident of the United Kingdom paying the dividend, the United States corporation shall be entitled to a payment from the United Kingdom of a tax credit equal to one half of the tax credit to which an individual resident in the United Kingdom would have been entitled had he received the dividend, subject to the deduction withheld from such payment and according to the laws of the United Kingdom of an amount not exceeding 5 per cent of the aggregate of the amount or value of the dividend and the amount of the tax credit paid to such corporation;

The tax credit in Article 10 is paid to the United States corporate shareholder for the tax period in which the ACT is paid or accrued by the United Kingdom corporation on the dividend distribution; that is, the period in which the United Kingdom shareholder would have received a credit under Section 86. This credit is not defeasible by subsequent events concerning how the United Kingdom uses its Section 85 offset, as the government asserts for the tax credit in Article 23.

Treaty Article 23 is retroactive to April 1, 1973. With only Article 23 in force in 1974, it was agreed

that a 1974 tax credit for the ACT paid by RXL in 1974 on the dividends to Xerox, if the credit were held to be available to Xerox, would apply to all the ACT at issue.

Article 23—Elimination of Double Taxation

23(1) In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principles hereof), the United States shall allow to a resident or national of the United States as a credit against the United States tax the appropriate amount of tax paid to the United Kingdom; and, in the case of a United States corporation owning at least 10 per cent of the voting stock of a corporation which is a resident of the United Kingdom from which it receives dividends in any taxable year, the United States shall allow credit for the appropriate amount of tax paid to the United Kingdom by that corporation with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid to the United Kingdom, but the credit shall not exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources outside of the United States) provided by United States law for the taxable year. For the purposes of applying the United States credit in relation to tax paid to the United Kingdom;

(a) the taxes referred to in paragraphs (2) (b) and (3) of Article 2 (Taxes Covered) shall be considered to be income taxes;

(b) the amount of 5 or 15 per cent, as the case may be, withheld under paragraph (2)(a)(i) or (ii) of Article 10 (Dividends) from the tax credit paid by the United Kingdom shall be treated as an income tax imposed on the recipient of the dividend; and

(c) that amount of tax credit referred to in paragraph (2)(a)(i) of Article 10 (Dividends) which is not paid to the United States corporation but to which an individual resident in the United Kingdom would have been entitled had he received the dividend shall be treated as an income tax imposed on the United Kingdom paying the dividend.

Thus for dividends distributed to a United States shareholder corporation, Article 10 provides that half of the ACT paid in the United Kingdom is repaid as a tax credit by the United Kingdom, and Article 23 provides that the remainder is allowed as a United States tax credit as if the ACT were an income tax in the United Kingdom.

The government's position is that the Article 23 tax credit for ACT paid is not available to a United States shareholder corporation until or unless the Section 85 offset has been used in the United Kingdom to offset mainstream corporation tax; that is, that the tax credit provided in Article 23(1)(c) is an interim or provisional credit, which in Xerox's case was withdrawn when RXL surrendered its Section 85 offset to its subsidiaries. The Court of Federal Claims so held.

DISCUSSION

In construing a treaty, the terms thereof are given their ordinary meaning in the context of the treaty and are interpreted, in accordance with that meaning, in the way that best fulfills the purposes of the treaty. *See United States v. Stuart*, 489 U.S. 353, 356-66 (1989) (interpreting a treaty to carry out the intent or expectations of the signatories); *Kolovrat v. Oregon*, 366 U.S. 187, 193-94 (1961) (a treaty should be interpreted to carry out its purpose). As discussed in *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176, 185 (1981), the court's role is "limited to giving effect to the intent of the Treaty parties." *See generally* Restatement (Third) of Foreign Relations Law of the United States, Part III, Introductory Note at 144-145 (1987). The judicial obligation is to satisfy the intention of both of the signatory parties, in construing the terms of a treaty. *Valentine v. United States*, 299 U.S. 5, 11 (1936) ("it is our duty to interpret [the treaty] according to its terms. These must be fairly construed, but we cannot add or detract from them.")

Unless the treaty terms are unclear on their face, or unclear as applied to the situation that has arisen, it should rarely be necessary to rely on extrinsic evidence in order to construe a treaty, for it is rarely possible to reconstruct all of the considerations and compromises that led the signatories to the final document. However, extrinsic material is often helpful in understanding the treaty and its purposes, thus providing an enlightened framework for reviewing its terms. *See Air France v. Saks*, 470 U.S. 392, 400 (1985) ("In interpreting a treaty it is proper, of course, to refer to the record of its drafting and ne-

gotiation.") However, "the ultimate question remains what was intended when the language actually employed . . . was chosen, imperfect as that language may be." *Great-West Life Assurance Co. v. United States*, 678 F.2d 180, 188 (Ct. Cl. 1982). In this context we have reviewed the evidence as well as the arguments proffered by both sides.

A. The Purpose of the Treaty

The stated purpose of the renegotiation, and the stated purpose of Article 23, is the elimination of double taxation of United Kingdom corporate distributions of dividends to United States shareholders. As explained by Paul W. Oosterhuis, an attorney for the Senate Joint Committee on Taxation, "generally favorable tax credit rules is an important concession to the United Kingdom which will make U.S. direct investment in the United Kingdom more attractive." (*quoted in Snap-On Tools, Inc. v. United States*, 26 Cl. Ct. 1045, 1069 (1992), *aff'd*, 26 F.3d 137 (Fed. Cir. 1994) (Table)). It is not disputed that the ACT on the dividends paid by RXL to Xerox in 1974 is subject to Article 23 of the Treaty.

Article 23 provides that "the United States shall allow credit for the appropriate amount of tax paid to the United Kingdom." It was stipulated in the Claims Court that Article 23(1)(c) provides a tax credit to the United States shareholder for ACT paid by the United Kingdom corporation, by treating the ACT as an income tax imposed on the United Kingdom corporation paying the dividend. The government's position, as we have stated, is that the Treaty permits the United States to reverse that tax credit unless or until the ACT it set off against mainstream corporation tax in the United Kingdom.

The Treaty does not mention such a condition on the allowance of foreign tax credit in the United States for ACT paid in the United Kingdom. Xerox argues that this omission is strong evidence that this restrictive condition was not intended by the signatories, for so dramatic a change in the effect of the Treaty—in this case defeating the purpose of avoiding double taxation on profits—should not be inferred by silence. Xerox argues that if the downstream disposition of the Section 85 offset were controlling of the availability of the benefit for which the Treaty was renegotiated, the Treaty could not have omitted stating this condition explicitly. Xerox states that the plain meaning of the Treaty, in the context of its purpose, does not permit its interpretation to require this modification.

Article 10 is relevant to understanding the plain meaning of the Treaty, as we have mentioned, because its provision, whereby the United Kingdom pays half of the tax credit for the ACT directly to the United States shareholder, is not dependent on whether or when the United Kingdom corporation or its United Kingdom subsidiaries uses the Section 85 offset against mainstream corporation tax. Indeed, no such dependency has been suggested by the government for Article 10.

United Kingdom shareholders receive the ACT credit whether or not the ACT offset is used, surrendered, or saved by the British payor of the dividend. Stipulated Fact 30 in the Claims Court record is that a United Kingdom shareholder "is entitled to the benefit of the U.K. shareholder credit in respect to the period in which the qualifying distribution is made," without regard to whether or how the U.K. company uses the ACT "in that accounting period or

in any other accounting period." This weighs against the government's argument that the Article 23 credit must be interpreted as not available to the United States shareholder until the occurrence of some subsequent event in the United Kingdom.

The government states that the United States always intended to restrict the availability of the ACT credit to United States taxpayers on the basis here asserted, and that this position was known to and was accepted by both signatories. In support, the government relies on the Treasury's Technical Explanation issued in 1977 and Revenue Procedure 80-18, documents we shall discuss *post*. In opposition, Xerox relies on the plain language of the treaty itself, its ratification history, and testimony of the chief negotiators for the United States and the United Kingdom. The 1986 Competent Authority Agreement is relevant, as are the provisions of the United States tax code with respect to foreign tax credits.

B. The Negotiation History

The Senate Report that accompanied the Treaty when it was presented for ratification in 1978 stated that "the United States agrees that it will continue to allow its U.S. citizens and residents to claim . . . the indirect foreign tax credit (Code sec. 902)." S. Exec. Rep. No. 95-18 at 32, *reprinted in* 1980-81 C.B. at 426. The Report explained that a reason for renegotiation of the existing treaty was to ensure that the ACT would be credited by the IRS:

> There is, therefore, a reasonable possibility that the ACT would not be viewed by the IRS as a creditable tax in the absence of the proposed treaty.

S. Exec. Rep. No. 95-18 at 34, *reprinted in* 1980-81 C.B. at 427. The Report explained that in the absence of the new treaty provisions, the ACT that was paid by the foreign corporation might not be creditable to the United States taxpayer until some later year in which United Kingdom mainstream tax liability was offset by the ACT:

> However, notwithstanding these technical difficulties [that ACT did not fit the IRS criteria for a creditable foreign tax], the ACT could be treated as a creditable income tax to the extent that it is allowed as an offset against the U.K. "mainstream" corporate tax, which is a creditable income tax. Under this treatment, in situations where the ACT is offset against a mainstream tax accruing in years subsequent to the dividend payment, no foreign tax credit would be allowed in the absence of the treaty until that later year in which the mainstream liability is offset.

S. Exec. Rep. No. 95-18 at 34, *reprinted in* 1980-81 C.B. at 427. Thus the position here taken by the government against Xerox was foreseen as occurring "in the absence of the proposed treaty," *id.*, and its remedy was a stated purpose of the Treaty.

Affidavits of negotiators for both sides were in accord with each other and with this purpose. Robert J. Patrick, Jr., International Tax Counsel for the Treasury and a principal negotiator for the United States, averred that the assumption during the negotiations was that under the Treaty "the U.S. foreign tax credit [for ACT paid to the U.K.] resulted in the resulting U.S. tax credits going to the U.S. cor-

porate shareholders in the year the dividend was paid, rather than revenues going to the U.S. Treasury." He and David S. Foster of the Treasury, who succeeded Patrick as International Tax Counsel, and Paul W. Oosterhuis of the Senate Joint Committee on Taxation, averred that Article 23 was not viewed during the negotiations as providing a "provisional" or "interim" credit for ACT: the theory on which the IRS withdrew, in 1980, the ACT credit it had allowed in 1974. Mr. Patrick averred that "[t]o the best of my knowledge, this interpretation of the Treaty has never previously been set forth by the United States, the United Kingdom, or anyone else." Mr. Oosterhuis averred that "[t]o the best of my recollection, the Treasury Department never presented to the Senate in its ratification procedure any explanation that the ACT is creditable under Article 23(1)(a) or that the credit for ACT under Article 23(1)(c) is an interim credit."

These statements are consistent with the clear text of the treaty and its purpose of avoiding double taxation of dividends. A provisional or interim credit, defeasible by actions of the distributing corporation six years later inside the United Kingdom, is in bold conflict with that plain meaning.

The negotiators for the United Kingdom testified to similar effect, and responded to the government's statements in the Claims Court that they had accepted the proposed interpretation. Lord Rees, the responsible Minister of the United Kingdom Government for this Treaty and the Minister of State at the British Treasury from 1979 to 1981, averred:

> As I stated in comments delivered to the House of Commons in January 1977 and again on 18th

> February 1980, a fair balance had to be struck between United States and United Kingdom portfolio and direct investors. . . . Developing a fair balance for the United States direct investor was more difficult but was eventually accomplished by the United Kingdom giving an immediate 50 percent refund (subject to a 5 percent withholding tax which was currently creditable against United States tax liability) and the United States giving an indirect foreign tax credit for the other 50 percent under Article 23(1)(c). *To strike the intended fair balance with United Kingdom shareholders, this indirect foreign tax credit had to be currently creditable. Therefore, to the extent that the United States Treasury Technical Explanation denies a current indirect foreign tax credit, it frustrates the policy underlying these provisions of the Treaty.* Consequently, had the United States Government interpretation of Article 23(1) been brought to my attention as the responsible Minister of the United Kingdom Government, *I would have raised objections to its interpretation* of the Treaty as being in conflict with the policy underlying the Treaty.

(Emphases added, citations to exhibits omitted.) The affidavit of the Rt. Hon. Denzil Davies, Minister of State at the Treasury from 1975 to 1979, was to the same effect, and equally strongly stated.

The government argues that there is "no reason to give any weight" to affidavits that were drafted after the Treaty entered into force. It is correct that *post facto* statements of legislators interpreting a statute are usually not acorded much weight, see

Consumer Product Safety Commission v. GTE Sylvania, Inc., 447 U.S. 102, 116-118 & n. 13 (1980), for it is seldom easy to reconstruct all of the legislative interests. Similar reasoning well applies to treaties. However, one need not ignore the identity and statute of the affiants, or the nature of their involvement, particularly when the affiants simply but strongly reinforce the plain meaning of the text of the treaty. When the recollections of the persons principally involved are fully consistent with the clear text of the treaty, and when no substantial contrary evidence has been proffered, these affidavits add weight to the wisdom expressed in *Rocca v. Thompson*, 223 U.S. 317, 332 (1912), that had the signatories intended the purpose now urged, "it would have been very easy to have declared that purpose in unmistakable terms."

C. The Technical Explanation

In 1977, in connection with the Senate ratification proceedings, the Treasury issued a Technical Explanation that stated, *inter alia*, that the United States foreign tax credit for ACT depended on when the ACT was used to offset mainstream tax in the United Kingdom, and that any credit previously given would be reduced accordingly:

> 1. ACT paid with respect to a distribution shall be treated as attributable to the accumulated profits (determined under U.S. principles) of the year of distribution, *except* in two circumstances:
>
> a) to the extent the ACT reduces mainstream tax for a prior or subsequent year; and

> b) if, after attribution of ACT which does not reduce mainstream tax, accumulated profits would not exceed corporate taxes for the year.
>
> ACT which reduces mainstream tax in any year or years shall be attributable to any accumulated profits of the year or years for which the mainstream tax is reduced. Where ACT is used to offset mainstream tax, the offset will be viewed as a refund of the ACT initially allowed as a credit and as a tax paid in respect of the year for which the ACT is applied as an offset. Consequently, a reduction in the foreign tax credit for the year from which the ACT is carried must be made in accordance with section 905(c) of the Code. . . .

Technical Explanation of the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains Signed at London, on December 31, 1975, as Amended by the Notes Exchanged at London on April 13, 1976, the Protocol Signed at London on August 26, 1976, and the Second Protocol signed at London on March 31, 1977 (herein "Technical Explanation"), submitted to the Senate Foreign Relations Committee at hearings held on July 19-20, 1977, *reprinted in* 1980-81 C.B. at 473-74.

This approach was referred to and criticized in general terms in the Senate Executive Report, as quoted *supra*. Referring specifically to the Technical Explanation, the Report mentioned the "difficult and complex issues" raised, and declined to "adopt or

reject" the "amplifications" in the Technical Explanation:

> The Treasury's technical explanation also set forth a complex set of rules and examples intended to be used for purposes of determining the earnings to which ACT payments by a U.K. corporation are to be attributed for purposes of computing the indirect foreign tax credit. . . .
>
> The ACT refunds, the withholding tax, and the unrefunded portion of the ACT are treated for U.S. foreign tax credit purposes in a manner which is generally favorable to U.S. shareholders. These rules raise difficult and complex issues. In recommending the ratification of the proposed treaty, the Committee does not intend that these rules necessarily serve as a model for future treaties. Further, in recommending the ratification of the treaty, the Committee does not intend to adopt or reject the amplifications of the foreign tax credit rules contained in the Treasury technical explanation. Consequently, Treasury would not be foreclosed by the ratification of the treaty from modifying those administrative interpretations in the future should it deem it advisable to do so. Of course, the rules contained in the treaty also do not limit any legislative action in this area; the computation of the foreign tax credit for unrefunded ACT may be subject to any generally applicable changes in the U.S. foreign tax credit rules which may subsequently be enacted.

S. Exec. Rep. No. 95-18 at 36-37, *reprinted in* 1980-81 C.B. at 429. One may debate the meaning of this cool treatment of the Technical Explanation. What

is clear, however, is that the Treasury's position was not embraced by the Senate. That this position is absent from the text of the Treaty is not surprising for, as the negotiators and the Senate recognized, it defeats the stated purpose of avoiding double taxation of the same profits.

A treaty must be construed in accordance with the intent of both signatories. Both of the United Kingdom's Ministers for the Treasury averred that they did not accept, or even know of, the position taken in the Technical Explanation:

> I can say categorically that I was not at any time as Minister or as a Member of the House of Commons shown the Technical Explanation, or briefed on the Technical Explanation or the point at issue in the case. Since I was the responsible Government Minister speaking for the Government in the debates before the House of Commons, I would be the only person to bring any such material befoer the House of Commons or authorize it to be deposited in the library of the House of Commons.
>
> * * *
>
> [T]he United Kingdom Government did not accept this United States Treasury Technical Explanation of Article 23 either explicitly or implicitly.
>
> * * *
>
> [W]hen the House of Commons approved the Order in Council giving effect to the Treaty as a matter of U.K. domestic law in February 1980, neither it nor I as the Minister responsible had any knowledge, express or implied, of the Technical Explanation. In these circumstances, it is

> not surprising that the United Kingdom voiced no objection to the Technical Explanation.

Affidavit of Lord Rees at 5-8. The Rt. Hon. Denzil Davies averred:

> I can state from my own knowledge that during the whole of the period when I was a Minister of State responsible for the Treaty, I had no knowledge of and never saw the United States Treasury Technical Explanation of the Treaty in any form.
>
> * * *
>
> [T]he United Kingdom Government of which I was a member and on whose behalf I was the responsible Minister in this matter did not accept the United States Treasury's Technical Explanation either explicitly or implicitly.

Affidavit of Rt. Hon. Denzil Davies at 5-6.

The government refers to the affidavit of a Treasury employee and member of the United States negotiating team, Steven P. Hannes, who stated that "copies of the Technical Explanation would have been sent to the U.K. negotiators." No evidence of such "sending" was provided, and it must be assumed that the Treasury's files contained no such support. On this extremely one-sided record, it would violate any reasonable canon of construction to infer mutual assent by the signatories to the position taken by the Treasury.

D. The Revenue Procedure

On the effective date, after the Treaty was ratified by both signatories, the Treasury issued Revenue Procedure 80-18, which introduced a different theory on which to deny the Article 23 credit for ACT, de-

pending on whether the United Kingdom corporation surrendered the Section 85 offset to subsidiaries in the United Kingdom:

> [F]or U.S. foreign tax credit purposes and pursuant to Article 23, the parent corporation has not paid or accrued the unrefunded ACT [Section 85] offset against the subsidary's mainstream tax and has contributed to the capital of the subsidiary an amount equal to the unrefunded ACT offset.

Rev. Proc. 80-18, § 3.05, *reprinted in* 1980-1 C.B. at 625. That is, if the British corporation that paid the ACT later surrenders the Section 85 offset to its subsidiaries, Revenue Procedure 80-18 treats that surrender as a contribution to the capital of the subsidiary, and reverses the tax credit previously granted pursuant to Article 23(1)(c). Thereafter, the government argues, ACT is creditable only under Article 23(1)(a). As we shall discuss, this interpretation strains the plain meaning of the treaty. It would also defeat the Treaty purpose of avoiding double taxation.

Revenue Procedures "do not have the force and effect of Treasury Department Regulations." 1980-81 C.B. at v. *See Helvering v. New York Trust Co.*, 292 U.S. 455, 468 (1934) (revenue rulings cited by the Commissioner "have none of the force or effect of Treasury Decisions and do not commit the Department to any interpretation of law"); *Spang Industries, Inc. v. United States*, 791 F.2d 906, 913 (Fed. Cir. 1986) ("a revenue ruling is entitled to some weight as reflecting the Commissioner's interpretation of the regulation, but does not have the same force as a regulation"); *State Bank of Albany*

v. United States, 530 F.2d 1379, 1382 (Ct. Cl. 1976) ("It may be helpful in interpreting a statute, but it is not binding on . . . the courts.") Thus although the Revenue Procedure warrants fair consideration as reflecting the Treasury's position, it is not insulated from inquiry.

The new theory offered in Procedure 80-18 leads to the faulty conclusion that Xerox's credit for the ACT that was paid by RXL on the dividends received by Xerox can be rescinded based on downstream activity within the United Kingdom. The internal disposition of ACT in any of the ways authorized by the Finance Act of 1972 is not relevant to the Section 23 credit. A foreign country's procedures do not determine United States tax credit rules, other than as encompassed within a Treaty. *United States v. Goodyear Tire & Rubber Co.*, 493 U.S. 132 (1989). A Revenue Procedure can not change the terms and purpose of a treaty. Procedure 80-18,[3] insofar as it would reverse Xerox's entitlement to the Article 23 credit for the ACT that was paid by RXL on the dividends paid to Xerox, is declared void.

E. The Competent Authority Agreement

A dispute, ambiguity, or uncertainty concerning a treaty is ideally resolved by the signatories themselves. Such a process can provide useful clarification, short of substantive change which would re-

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[3] Another aspect of Revenue Procedure 80-18 was rejected by the Court of Claims in *Brown & Williamson, Ltd. v. United States*, 688 F.2d 747, 752 (Ct. Cl. 1982). A still different aspect was voided by the Claims Court in *Snap-On Tools v. United States*, 26 Cl. Ct. 1045, 1065 (1992), *aff'd*, 26 F.3d 137 (Fed. Cir. 1994) (Table).

quire ratification. The Treaty's Article 25 provides for such a "Mutual Agreement Procedure." This procedure was invoked in 1986 at the initiative of the United States with the approval of the Claims Court, while this case was pending.

After a period of discussion, an agreed letter from the United States Competent Authority (by delegation of the Secretary of the Treasury, the Competent Authority was the Associate Commissioner (Operations) of the Internal Revenue Service), to the United Kingdom Competent Authority, was issued on December 18, 1986 and accepted on December 23, 1986. The Agreement states, in substantial part:

> 1. It is agreed that Article 23(1)(c) provides a mechanism by which a U.S. foreign tax credit may be obtained for that part of the U.K. tax credit referred to in Article 10(2)(a)(i) which is not paid to a U.S. corporation but to which an individual resident in the United Kingdom would have been entitled had he received the dividend.
>
> 2. It is agreed that Article 23(1)(c) was included in the Convention for the purpose of ensuring that in accordance, with Article 23(1)(a) the Advance Corporation Tax ("ACT") payment which generally underlies the U.K. tax credit referred to in paragraph 1 would be treated as an income tax paid to the United Kingdom by the U.K. corporation paying the dividend, because the United States questioned to what extent, in the absence of the Convention, payments of ACT would be treated as payments of a creditable corporate income tax for U.S. foreign tax credit purposes.

3. It is agreed that, pursuant to Article 23(1), the Article 23(1)(c) mechanism must be applied in accordance with the provisions and subject to the limitations of the law of the United States and that a credit is to be given under Article 23(1)(c) only for the appropriate amount of tax paid to the United Kingdom.

4. It is agreed that Article 23(1) of the convention was not intended to provide two U.S. foreign tax credits for a single payment of ACT to the United Kingdom or U.S. foreign tax credits in excess of the amount of corporation tax (including both ACT and mainstream corporation tax) paid to the United Kingdom in respect of the profits out which a dividend is paid.

5. It is agreed that under the language of Article 23(1) which provides that the Article 23(1)(c) credit must be allowed in accordance with the provisions and subject to the limitations of the law of the United States, the timing of the credit is to be determined as a matter of U.S. law.

We discern no substantive change from the Treaty provisions. The Agreement summarizes the Treaty purpose and its implementation as applied to the ACT, deplores the taking of double credit in the United States, and confirms that United States law applies to the timing of the credit. Xerox points out that this Agreement did not treat the important aspects of the Treasury's litigation position, such as that the Article 23 credit is only provisional, or that downstream surrender of the Section 85 offset in the United Kingdom permits or requires revocation of the Article 23 credit.

The Treasury states that paragraph 5 of the Agreement is important because it provides that United States law determines the timing of the credit, and that Revenue Procedure 80-18 "elaborates" United States law and thus controls this case. As we have discussed *supra*, a Revenue Procedure is neither law nor regulation, and is not binding on the courts. The Competent Authority Agreement is silent on the Section 85 offset and the effect of when and how that offset is used in the United Kingdom. This was the main issue in dispute, then and now. The omission from the Agreement of the positions taken in this Revenue Procedure and the earlier Technical Explanation appears to us to emphasize the weaknesses in the government's argument.

The Agreement's affirmation that the timing of the tax credit is governed by United States law directs us to the Internal Revenue Code. As we next discuss, the Code allows the United States taxpayer an indirect foreign tax credit for, *inter alia*, income taxes paid by the foreign corporation on dividends to the United States shareholder, the credit to be taken when the foreign tax is paid or accrued.

Finally, there is no issue here of double tax credit in the United States. Although the government devotes a significant portion of its brief to this spectre, it is undisputed that this taxpayer has not received single tax credit, and has made no claim that is suspect on this ground.

F. The Internal Revenue Code Provisions

A treaty, when ratified, supersedes prior domestic law to the contrary, *United States v. Lee Yen Tai*, 185 U.S. 213, 220-22 (1902), and is equivalent to an act of Congress. However, tacit abrogation of

prior law will not be presumed and, unless it is impossible to do so, treaty and law must stand together in harmony. In this case there is easy harmony between the Treaty and the United States law governing foreign tax credits, §§ 901-906 of the Internal Revenue Code of 1954.

In construing the tax law, as for any statute, the starting point is the words of the statute, *Bread Political Action Committee v. Federal Election Commission*, 455 U.S. 577, 580 (1982), taking the words in their ordinary meaning in the field of interest, *Perrin v. United States*, 444 U.S. 37, 42 (1979), and giving full effect to "every word Congress used." *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979). As a special rule in tax cases, "if doubt exists as to the construction of a taxing statute, the doubt should be resolved in favor of the taxpayer." *Hassett v. Welch*, 303 U.S. 303, 314 (1938); *Auto-Ordnance Corp. v. United States*, 822 F.2d 1566, 1571 (Fed. Cir. 1987).

26 U.S.C. § 902

Revenue Code § 902 authorizes, *inter alia*, a tax credit under 26 U.S.C. § 901 for income taxes paid to a foreign government when a domestic corporation owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year. The Treaty, by defining ACT as an income tax, brought ACT within the purview of § 902. In accordance with § 902(a), the domestic corporation shall "be deemed to have paid the same proportion of any income . . . taxes paid or deemed to be paid by such foreign corporation to any foreign country . . . on or with respect to such accumulated profits." Section 902 also includes pro-

visions relating to second and third tier foreign corporations that pay dividends through their parent corporation to the United States corporation.

Each party states that § 902 supports its position. The government states that since § 902 permits a tax credit involving second tier foreign corporations, credit for the ACT paid by RXL in 1974 was properly reversed when RXL surrendered the Section 85 offset to its subsidiaries. The government's position is that credit for this ACT can not be allowed to Xerox until "each foreign subsidiary up the line distributes dividends to its parent."

We do not share this reasoning. The ACT here at issue was for dividends that were paid to Xerox in 1974; the ACT on those dividends was paid by RXL in the United Kingdom in 1974, and was not refundable or reversible. The second-tier RXL subsidiaries did not pay, and had no obligation to pay, the ACT on those dividends. The ACT obligation by RXL was completed in 1974, and was not defeasible by whether, when, or how RXL used its offset rights under United Kingdom law, including whether and when the offset was surrendered to RXL's subsidiaries in the United Kingdom.

In accordance with §§ 901 and 902, Xerox was entitled to the credit when the dividends were distributed to Xerox and the ACT thereon was paid or accrued by RXL, see § 905. The straightforward reading of the Code provisions firmly links the foreign tax credit to the payment to the United States shareholder of dividends on which foreign income tax was paid. In *United States v. Goodyear* the Court reaffirmed that under § 902 the dividends received by the United States parent must be sourced to the year

in which the foreign subsidiary paid the foreign tax, citing "§ 902's statutory goal of avoiding double taxation." *Goodyear*, 493 U.S. at 144. That principle is not served by the government's theory.

In view of our conclusion that the conditions now imposed on ACT credits have no support in § 902 and are contrary thereto, we do not reach Xerox's alternative argument that in accordance with § 902 Xerox is entitled to the tax credit even without recourse to the Treaty.

26 U.S.C. § 905

The government also relies on Code Section 905, which relates to adjustments to and accounting periods for indirect foreign tax credits. Section 905(a) allows the foreign tax credit to be taken in the year in which the foreign tax accrues, and requires consistency in accounting:

> § 905(a) Year in which credit taken.
>
> The credits provided in this subpart may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subsection (c). If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken on the same basis, and no portion of any such taxes shall be allowed as a deduction in the same or any succeeding year.

Section 905(c) does not determine entitlement, but authorizes recalculation of the tax credit if the amount of foreign tax is refunded or adjusted after the credit is taken.

> § 905(c) Adjustments on payment of accrued taxes.
>
> If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the Secretary or his delegate, who shall redetermine the amount of tax for the year or years affected. The amount of tax due on such redetermination, if any, shall be [paid or credited]. . . . In such redetermination by the Secretary or his delegate of the amount of tax due from the taxpayer for the year or years affected by a refund, the amount of the taxes refunded for which credit has been allowed under this section shall be reduced by the amount of any tax described in section 901 imposed by the foreign country or possession of the United States with respect to such refund; but no credit under this subpart, and no deduction under section 164 (relating to deduction for taxes) shall be allowed for any taxable year with respect to such tax imposed on the refund . . . .

The Court of Federal Claims erred in its reliance on § 905(c) as substantive basis for the withdrawal of credit upon the 1980 surrender by RXL of the Section 85 offset. Section 905(c) indeed permits redetermination of the foreign tax credit when any foreign tax is refunded or adjusted. However, the

ACT paid in 1974 was not refunded or adjusted in 1980. The movement of the Section 85 offset from British parent to subsidiary is not a refund or adjustment of the ACT. This tax obligation in the United Kingdom was fixed and paid in 1974, when the dividends were paid to Xerox. It is not refundable, and no adjustment of the 1974 United States tax credit is warranted. Neither § 902 nor § 905 supports the reversal or postponement of credit for the ACT paid by RXL in 1974.

CONCLUSION

Review of the evidence and arguments persuades us that the Treaty's meaning on this issue is plain and unambiguous, and that it should not be construed contrary to its clear purpose of avoidance of double taxation. It is inappropriate for courts to depart from the purpose and import of a treaty, "particularly [when] there is no indication that application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories." *Maximov v. United States*, 373 U.S. 49, 54 (1963).

The ACT is a separate tax, and is not properly viewed as a prepayment or interim credit or estimated tax of mainstream corporate tax. The ACT does not become provisional by virtue of the offset procedures available under United Kingdom law. The Treaty requires that the unrepaid (under Article 10) portion of the ACT be "treated as an income tax," Article 23(c), thus accommodating §§ 901 *et seq.* of the Revenue Code.

We conclude that the ACT is creditable in the United States, in accordance with § 902, in the year

it is paid or accrued in the United Kingdom. RXL's subsequent disposition of its offset rights under the Finance Act of 1972 did not defeat the foreign tax credit for ACT, which vested in Xerox when the tax and dividends were paid.

The decision of the Court of Federal Claims is reversed. Payment of the claimed refund is ordered, calculated in accordance with law.

COSTS

Costs in favor of Xerox.

REVERSED

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

93-5094

XEROX CORPORATION, PLAINTIFF-APPELLANT

v.

THE UNITED STATES, DEFENDANT-APPELLEE

On Appeal from the United States Court of Federal Claims in Case No(s). 80-85T

JUDGMENT

This CAUSE having been heard and considered, it is

ORDERED and ADJUDGED: REVERSED

ENTERED BY ORDER OF THE COURT

/s/ Francis X. Gindhart
FRANCIS X. GINDHART
Clerk

Dated Dec. 6, 1994

Issued as a mandate: February 2, 1995

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

ORDER

Before RICH, Circuit Judge, NEWMAN, Circuit Judge, and PLAGER, Circuit Judge.

A petition for rehearing having been filed by the APPELLEE,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for rehearing be, and the same hereby is, DENIED.

The mandate will issue February 14, 1995.

FOR THE COURT
FRANCIS X. GINDHART
Clerk

by /s/ Diane M. Frye
Clerk
DIANE M. FRYE
Chief Deputy Clerk

Dated: February 7, 1995

APPENDIX D

IN THE UNITED STATES CLAIMS COURT

No. 80-85T

(Filed: March 17, 1988)

XEROX CORPORATION, PLAINTIFF

v.

THE UNITED STATES, DEFENDANT

U.S.-U.K. Income Tax Treaty for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion (1975); U.K. Imputation System; U.K. Advance Corporation Tax (ACT); U.S. Foreign Tax Credit; Treaty Interpretation; Intent of Treaty Parties; Effect of Technical Explanation and Competent Authority Agreement; Administrative Implementation

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OPINION

FUTEY, Judge.

Plaintiff brought this action seeking recovery of federal income taxes totaling $6,333,334 (or such larger sum as is legally due) plus assessed, restricted,

and statutory interest for its taxable year ended December 31, 1974. Plaintiff alleged eleven separate grounds of recovery in its complaint, one of which claimed that plaintiff was entitled to a refund of $1,826,222 for an indirect foreign tax credit pursuant to Article 23(1)(c) of the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains (hereinafter the "US-UK Income Tax Treaty" or "Convention"). Defendant answered by denying that plaintiff was entitled to recover on the above or any other causes of action listed in the complaint. While the parties are attempting to resolve the other causes of action without litigation, trial was held on the treaty issue. For the reasons discussed hereinafter, the court concludes that plaintiff is not entitled to an indirect foreign tax credit for the sum here at issue under Article 23(1)(c) of the US-UK Income Tax Treaty. Accordingly, the court holds for defendant and dismisses the above cause of action.

FACTS

Plaintiff, Xerox Corporation, is a New York corporation engaged in the manufacture and sale of a full range of xerographic and other office equipment products. The company's principal office is in Stamford, Connecticut. As the parent corporation of an affiliated group of corporations, plaintiff files consolidated federal income tax returns on a calendar year basis and employs the accrual method of accounting.

One of the affiliated corporations of the said affiliated group of corporations is Lyell Holdings, Ltd.,

a Delaware corporation (hereinafter "Lyell"). Lyell is wholly owned by Xerox and is a resident United Kingdom ("U.K.") corporation. Lyell is treated as a U.K. resident for all U.K. tax purposes.

During 1974 and at all times relevant to this litigation plaintiff owned, directly and through Lyell, a majority of the outstanding voting shares of Rank Xerox, Limited ("RXL"). RXL is a U.K. corporation whose principal office was during 1974, and for many years thereafter, in London, England, U.K. RXL is engaged directly and through multiple U.K. and foreign subsidiary corporations in businesses in the Eastern Hemisphere which are generally comparable to those conducted in the United States by plaintiff and its U.S. subsidiary corporations. RXL has non-U.K. operating subsidiary corporations in most of the major countries of Europe and in many other parts of the Eastern Hemisphere. RXL also owns the share capital of various U.K. corporations, some of which are relevant to this case. The particular U.K. subsidiaries of RXL which are relevant to the instant litigation are:

(a) Rank Xerox Management Ltd. ("RXM"), incorporated in 1965—a holding company owning the share capital of numerous non-U.K. corporations in Europe and other portions of the Eastern Hemisphere;

(b) Rank Xerox (U.K.) Ltd. ("RX-UK"), incorporated in 1937—an operating company engaged in the business of marketing xerographic equipment in the U.K.; and

(c) Rank Xerox Ireland Ltd. ("RX-Ireland"), incorporated in 1937—an operating company engaged

in the business of marketing xerographic equipment in Ireland.

The outstanding shares of RXL which are not owned, directly or indirectly, by Xerox are owned by the Rank Organization Plc. ("RO"), an unrelated publicly held U.K. corporation and its subsidiaries. Also, a limited class of shares of RXL are held by certain key employees of RXL as part of a key executive compensation plan. The share ownership of RXL as of the end of its fiscal year 1974 was as follows:

Classes of Shares	Par Value in Pounds	Number of Shares Outstanding
A	1	7,401,254
B	1	7,401,254
C	1	7,481,388
D	1	3,740,694
E	1	49,350

Class A, B and E shares are non-voting; Class C and D shares are voting shares. Class A and B shares participate equally in pre-tax profits of RXL up to 7,401,254 pounds and Classes C, D and E shares participate in profits in excess of 7,401,254 pounds. Plaintiff held directly 6,356,147 Class C shares. Lyell held all of the Class A shares and 1,125,241 of the Class C shares. RO held all of the Class B and D shares of RXL either directly or through affiliated companies. Key employees held the Class E shares of RXL. Lyell and RO together own over 75% of the ordinary share capital of RXL for U.K. tax purposes.

* * * *

During 1972, the U.K. enacted legislation that significantly altered the U.K. system for taxing corpora-

tions and their shareholders. This new legislation, adopting what is generically known as an "imputation system," was enacted as the Finance Act of 1972 (hereinafter "FA 1972").

Under FA 1972, a corporation tax is imposed on U.K. resident corporations on the income and chargeable gains which are derived in a given accounting period. An "accounting period" for purposes of U.K. tax law is the period by reference to which assessments for corporation tax are made. Normally, an accounting period is 12 months. RXL and its subsidiaries had, during 1974 and at all other relevant times, a 12-month accounting period ending October 31.

The corporation tax assessed against the income and chargeable gains of any accounting period is generally due 9 months after the close of such accounting period. There are certain exceptions to this 9-month period for corporations formed prior to April 1965. RXL, which was formed prior to April 1965, has 18 months from the end of its accounting period in which to pay its corporation tax.

Section 84 of FA 1972 provides that where a corporation resident in the U.K. makes a "qualifying distribution" during its accounting period and such distribution is not made out of "franked investment income," an Advance Corporation Tax (hereinafter "ACT") is imposed on the corporation resident in the U.K. making such qualifying distribution. The term "qualifying distribution" as used in FA 1972 includes all dividends. The term "franked investment income," defined in section 88, FA 1972, refers to a qualifying distribution received by a corporation resident in the U.K. from another corporation resident in the U.K. which carries a related U.K. shareholder

credit granted by section 86, FA 1972. "Franked investment income" includes both the qualifying distribution and related tax credit. Such amount is also termed a "franked payment" when reference is made to the amount distributed by the distributing company.

A financial year in the U.K. is the year beginning on April 5 and ending on the succeeding April 4. Thus, the 1974 financial year ran from April 5, 1973 to April 4, 1974. The rate of ACT imposed during that financial year was equal to 3/7 of the amount of a qualifying distribution.

If ACT is paid (and not repaid) by a U.K. resident corporation making a qualifying distribution, such distributing corporation may use the ACT payment in the following ways:

(a) it may offset the ACT (subject to certain limits) against its own corporation tax liabiilty, *i.e.*, use ACT to satisfy its U.K. corporation tax liability, in respect of the accounting period in which the qualifying distribution is made. Section 85(1), FA 1972;

(b) if the amount of its corporation tax liability in respect of that accounting period is insufficient to absorb the whole of that ACT payment, it may offset the ACT against its corporation tax liabilities in respect of the two preceding accounting periods (on the basis of the latter of the two preceding years first). Section 85(3), FA 1972;

(c) if, after the application of (a) and (b) above, ACT remains unabsorbed as an offset against the U.K. corporation tax liability of the current or two prior accounting periods, the distributing company may carry forward for an indefinite period the unabsorbed ACT and offset it against its corporation

tax liabilities for subsequent periods. Section 85(4) FA 1972;

(d) instead of offsetting the ACT payment against its own U.K. corporation tax liability, the distributing company may, under section 92, FA 1972, "surrender" that right to set off ACT against U.K. corporation tax liability (to the extent that an ACT payment arises as a result of the payment of a dividend and not any other kind of qualifying distribution) to one or more of its 51 percent or greater owned subsidiaries. If ACT is surrendered, a subsidiary to which the surrender has been made may set off the ACT surrendered to it (subject to certain limits) against its own U.K. corporation tax liability in respect of the accounting period in which the dividend giving rise to the ACT was paid. To the extent that such corporation tax liability is insufficient to absorb the ACT set off, the company to which the surrender is made (hereinafter "surrenderee") may carry the surrendered ACT set off forward (but not back) for an indefinite period for set off against its U.K. corporation tax liabilities in subsequent periods. A surrenderee cannot make a further surrender of ACT. Section 92(3A), FA 1972.

If a resident U.K. corporation makes a qualifying distribution in one calendar quarter and pays ACT with respect to such distribution, it may obtain a refund of such ACT from Inland Revenue if and to the extent it receives franked investment income during the remainder of the same accounting period. This is the only circumstance by which a distributing company can obtain a refund of ACT paid, and such circumstance is the sole reason for the parenthetical "(and not repaid)" in section 85(1), FA 1972.

A resident U.K. corporation making a qualifying distribution which is not out of franked investment income must pay ACT regardless of its income whether or not it has any U.K. corporation tax liability which could be satisfied by use of the associated section 85 offset. For this reason and because ACT is not refundable, ACT is not an "estimated tax" payment and is not similar to U.S. corporate estimated tax payments.

When a resident U.K. corporation pays a dividend to another resident U.K. corporation which owns either 51% or more of the ordinary share capital of the distributing company or is a member of a "consortium" [1] owning such company, the distributing company and distributee may jointly elect to treat the dividend as "group income" which operates to exclude the dividend from the requirements of section 84(1), FA 1972 (liability to pay ACT), and from the benefits of section 86, FA 1972 (right to shareholder credit). A group income election does not affect the U.K. corporation tax liability of either the distributing company or the distributee. The distributing company is and remains liable for U.K. corporation tax on its profits out of which any such distribution is made and the distribution does not constitute income to the distributee.

Except with respect to qualifying distributions for which a group income election has been made, U.K.

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[1] A "consortium" is defined under U.K. law (as in effect in 1974) as a group of four or fewer resident U.K. corporations which in the aggregate own 75% or more of the ordinary share capital of another resident U.K. corporation and separately each own at least 5% of the ordinary share capital.

resident shareholders (individual and corporate) receiving qualifying distributions from U.K. resident corporations are entitled to a U.K. shareholder credit under section 86, FA 1972. The U.K. resident shareholder entitled to the U.K. shareholder credit is able to claim such tax credit even in situations where the distributing U.K. resident company making the qualifying distribution has not paid ACT with respect to the distribution and has no franked investment income out of which a qualifying distribution may be made without the payment of additional ACT.

If the recipient of a qualifying distribution is a U.K. resident individual, he is treated, for U.K. income tax purposes, as having received income equal to the aggregate of the amout or value of the qualifying distribution plus the amount of the U.K. shareholder credit. The U.K. shareholder credit is equal to such proportion of the amount or value of the qualifying distribution as corresponds to the rate of ACT force for the financial year in which the distribution is made. Setcion 86(2), FA 1972. The U.K. shareholder credit received as a result of the receipt of a qualifying distribution may be applied by that individual against his own income tax liability for the assessment period in which the qualifying distribution is subject to income tax. To the extent that the U.K. shareholder credit exceeds the individual's income tax for such period, he is entitled to a cash payment of the excess by the U.K. Inland Revenue (section 86(4), FA 1972), regardless of whether or not the U.K. resident company paying the dividend to him has itself paid ACT in relation to that dividend and regardless of whether such distributing company had received franked in-

vestment income out of which to make such distribution.

A U.K. resident company receiving a qualifying distribution from another such company is also entitled to a U.K. shareholder credit as a result of the receipt of the franked payment. Section 86(1), FA 1972. A U.K. resident company which receives a distribution in respect of which it is entitled to a U.K. shareholder credit, is treated, by section 88, FA 1972, as having received "franked investment income". The receipt of franked investment income correspondingly relieves the U.K. company receiving such income from the liability which would otherwise arise to pay ACT in relation to qualifying distributions made by it to the extent of its franked investment income. Section 89(1), FA 1972.

The U.K. resident individual shareholder receiving a qualifying distribution and, with it, the associated U.K. shareholder credit, may only use that shareholder credit in respect of the assessment period in which the distribution is made. Similarly, the U.K. resident corporate recipient is entitled to the benefit of the U.K. shareholder credit in respect of the period in which the qualifying distribution is made. It makes no difference, for this purpose, whether the U.K. company making the distribution has or has not itself paid ACT, or is able to use ACT in any of the aforementioned ways during that accounting period or in any other accounting period.

* * * *

Under the Finance Act of 1972, a non-resident of the U.K., individual or corporate, does not receive the benefit of the section 86 U.K. shareholder credit. Thus, the U.K.'s imputation system discriminates against non-resident shareholders in U.K. corpora-

tions by taxing profits distributed to them at both the corporate and shareholder levels, while profits distributed to U.K. shareholders are taxed only at the corporate level. Section 497 of the U.K. Income and Corporation Taxes Act of 1970, however, allows bilateral income tax treaties between the U.K. and other countries to confer on such non-residents a right to the U.K. tax credit granted under section 86, FA 1972. To alleviate the discrimination against U.S. shareholders of U.K. corporations, the United States negotiated a new treaty with the United Kingdom (the US-UK Income Tax Treaty) which was signed on December 31, 1975, and came into force on April 25, 1980.

The salient provisions of this treaty are Article 10, entitled "Dividends," and Article 23, entitled "Elimination of Double Taxation." The pertinent sections thereof read as follows:

Article 10—Dividends

(2)(a) In the case of dividends paid by a corporation which is a resident of the United Kingdom:

(i) to a United States corporation which either alone or together with one or more associated corporations controls, directly or indirectly, at least 10 percent of the voting stock of the corporation which is a resident of the United Kingdom paying the dividend, the United States corporation shall be entitled to a payment from the United Kingdom of a tax credit equal to one-half of the tax credit to which an individual resident in the United Kingdom would have been entitled had he received the dividend,

subject to the deduction withheld from such payment and according to the laws of the United Kingdom of an amount not exceeding 5 percent of the aggregate of the amount or value of the dividend and the amount of the tax credit paid to such corporation;

(ii) in all other cases, the resident of the United States to whom such dividend is paid shall be entitled to a payment from the United Kingdom of the tax credit to which an individual resident in the United Kingdom would have been entitled had he received the dividend, subject to the deduction withheld from such payment and according to the laws of the United Kingdom of an amount not exceeding 15 percent of the aggregate of the amount or value of the dividend and the amount of the tax credit paid to such resident;

(iii) the aggregate of the amount or value of the dividend and the amount of the tax credit referred to in sub-paragraphs (a) (i) and (ii) of this paragraph paid by the United Kingdom to the United States corporation or other resident (without reduction for the 5 or 15 percent deduction, as the case may be, by the United Kingdom) shall be treated as a dividend for United States tax credit purposes.

Article 23—Elimination of Double Taxation

(1) In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof) the United States shall allow to a resident or

national of the United States as a credit against the United States tax the appropriate amount of tax paid to the United Kingdom; and, in the case of a United States corporation owning at least 10 percent of the voting stock of a corporation which is a resident of the United Kingdom from which it receives dividends in any taxable year, the United States shall allow credit for the appropriate amount of tax paid to the United Kingdom by that corporation with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid to the United Kingdom, but the credit shall not exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources outside of the United States) provided by United States law for the taxable year. For the purposes of applying the United States credit in relation to tax paid to the United Kingdom:

(a) the taxes referred to in paragraphs (2)(b) and (3) of Article 2 (Taxes Covered)[2] shall be considered to be income taxes;

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[2] These paragraphs read as follows:

(2) the existing taxes to which this Convention shall apply are:

(b) in the case of the United Kingdom, the income tax, the capital gains tax, the corporation tax and the petroleum revenue tax. The foregoing taxes covered are hereinafter referred to as "United Kingdom Tax";

(3) This Convention shall also apply to any identical or substantially similar taxes which are imposed by a Contracting State or its political subdivisions or local authorities after the date of signature of this Convention in addition to,

(b) the amount of 5 or 15 percent, as the case may be, withheld under paragraph (2)(a)(i) or (ii) of Article 10 (Dividends) from the tax credit paid by the United Kingdom shall be treated as an income tax imposed on the recipient of the dividend; and

(c) that amount of tax credit referred to in paragraph (2)(a)(i) of Article 10 (Dividends) which is not paid to the United States corporation but to which an individual resident in the United Kingdom would have been entitled had he received the dividend shall be treated as an income tax imposed on the corporation paying the dividend.

The Article 23(1) U.S. tax credit for taxes paid to the U.K. was given retroactive application to April 1, 1973. However, the Article 10(2)(a)(i) U.K. payment with respect to dividends distributed by a U.K. corporation to a (10% or greater) U.S. corporate shareholder was given retroactive application only to April 6, 1975. Thus, during the 1974 tax year at issue in this action, the U.S. foreign tax credit plaintiff claims under Article 23(1)(c) was not defrayed by any U.K. payment under Article 10(2)(a)(i).

* * * *

During 1974, RXL paid the following amounts of dividends to its shareholders and ACT to the United Kingdom tax authorities with respect to such dividends (in pounds sterling):

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or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any changes which have been made in their respective taxation laws.

Shareholder	Amount of Dividend
Plaintiff (including Lyell)	9,166,714
RO and Affiliates and Class E Shareholders	4,833,286
Total Dividends	14,000,000
ACT	6,000,000

The applicable exchange rate for conversion of pounds sterling to dollars for U.S. foreign tax credit purposes in 1974 is 2.3335 dollars to one pound. Accordingly, the dollar equivalents of the foregoing amounts are as follows:

Shareholder	Amount of Dividend
Plaintiff (including Lyell)	$21,390,527
RO and Affiliates and Class E Shareholders	$11,278,473
Total Dividends	$32,669,000
ACT	$14,000,000

Under U.K. law, a foreign tax credit against U.K. corporation tax is granted by reason of the receipt of dividends from non-U.K. resident corporations out of the income of such non-U.K. resident corporations which has been subject to an income tax in a foreign jurisdiction.

The section 85 set off against U.K. corporation tax, if not surrendered, satisfies U.K. corporation tax liability prior to the use of any foreign tax credits to satisfy such U.K. corporation tax liability. Foreign tax credits arising under U.K. law by reason of the receipt of dividends from non-U.K. resident corporations which are not used against the U.K. corporation tax liability of the U.K. resident corporation receiving such dividends for the account-

ing period in which the dividends are received are lost and may not be carried back or carried forward.

In order to avoid losing sizeable foreign tax credits under U.K. law, RXL surrendered a portion of the ACT offset arising from its 1974 dividend, and satisfied a substantial portion of its 1974 corporation tax liability by using foreign tax credits it would otherwise have lost had such ACT set off not been surrendered.

Of the 6,000,000 pounds ($14,000,000) of ACT paid by RXL in 1974, 4,407,855 pounds ($10,285,730) was subsequently surrendered to its subsidiaries RX-UK, RXM, and RX-Ireland to be used in reducing their U.K. corporation tax liabilities. Only 1,592,145 pounds ($3,715,270) of the ACT paid in 1974 was applied in reduction of RXL's U.K. corporation tax liability for the tax year 1974.

The parties agree that the latter sum qualifies for credit in 1974 under Article 23(1) of the US-UK Income Tax Treaty, which took effect on April 25, 1980. However, defendant disputes plaintiff's claim that such credit should also apply to any of the 4,407,855 pounds ($10,285.730) of surrendered ACT.

On February 28, 1984, plaintiff filed a timely claim with the Internal Revenue Service (based on the above and other causes of action) for refund of federal income tax in the amount of $5,272,575, or such greater amount as is legally refundable, for the tax year 1974. Plaintiff amended this claim on February 26, 1985, in the additional amount of $1,052,650 or such greater amount as is legally refundable.

No action having been taken by IRS on the February 28, 1984 refund claim, and more than six months having passed since filing as required by section 6532 of the Internal Revenue Code, plaintiff

filed its complaint in this court on February 7, 1985, in the principal sum of $6,333,334. The complaint listed eleven causes of action, the second of which claimed entitlement to additional foreign tax credit in the amount of $3,511,965, which after adjustment (for the additional deemed dividend of the amount under section 78 of the Internal Revenue Code) would result in a refund to the plaintiff of $1,826,222 with respect to the indirect foreign tax credit provided under Article 23(1)(c) of the US-UK Income Tax Treaty.

Trial was held on the treaty issue in Washington, D.C. on October 13-14, 1987.

DISCUSSION

The issue at bar is whether the surrender by RXL of a portion of its section 85 offset to U.K. subsidiaries should have any effect on the availability of an Article 23(1)(c) U.S. foreign tax credit to its parent, Xerox. Plaintiff contends that RXL's surrender of the balance of its section 85 offset does not affect Xerox's entitlement to the full Article 23(1)(c) U.S. foreign tax credit in the 1974 year of distribution. Defendant's position, however, is that the indirect foreign tax credit granted to Xerox (and Lyell) under the provisions of Article 23 should be calculated as if RXM, RX-Ireland, and RX-UK, rather than RXL, had actually paid the ACT which was used to satisfy portions of their corporation tax liabilities. In other words, Xerox should receive no Article 23(1)(c) credit for any ACT offset surrendered by RXL.

Plaintiff builds its case for a full indirect foreign tax credit under Article 23(1)(c) on three lines of reasoning:

(1) The U.S. foreign tax credit provided by the terms of Article 23(1)(c) is based on the shareholder credit under section 86, FA 1972, and not on the payment of ACT under section 84, so that the use of the section 85 offset by the payor of the dividend or its surrenderee is irrelevant to the issue of when the Article 23(1)(c) credit is properly taken into account.

(2) Even if Article 23(1)(c) were considered to provide a U.S. foreign tax credit for section 84 ACT, ACT is a tax which is paid or accrued in the year the related dividend is paid and therefore, under U.S. law, gives rise to a U.S. foreign tax credit in the year of distribution.

(3) In no event can a surender under section 92, FA 1972, make the surrenderee the "taxpayer" of ACT under U.S. or U.K. law, or the "corporation paying the dividend" under the language of Article 23(1)(c) of the Treaty.

Plaintiff contends that these arguments are supported by both the language and purpose of Articles 10 and 23 of the Treaty.

Defendant, however, contends that these Articles inextricably link the U.S. foreign tax credit to the payment of ACT and the year of its application against U.K. corporation tax liability. According to this view, the Article 23(1)(c) U.S. foreign tax credit arising as a result of the U.K. subsidiary's dividend distribution and payment of ACT applies only until the ACT is used to offset U.K. corporation tax liability. Thus, in the event the section 85 ACT offset is surrendered, in whole or in part, to another U.K. corporation and applied against its U.K. corporation tax liability, the U.S. direct investor's Article 23(1)(c) credit becomes an Article 23(1)(a)

credit, no longer applicable in the year of dividend distribution but rather in the year the offset is applied against the surrenderee's U.K. corporation tax liability. Defendant points to the language and purpose of Articles 10 and 23, as well as the explicit interpretations thereof by both treaty parties, as supporting the foregoing argument.

Article 10(2)(a)(i)

Plaintiff, in support of its theory that the Article 23(1)(c) U.S. foreign tax credit is based on the section 80 shareholder credit and independent of the section 84 payment of ACT or the section 85 offset, cites the following language from Articles 10(2)(a)(i) and 23 (l)(c) of the Treaty.

Article 10(2)(a)(i)

> ". . . the United States corporation shall be entitled to a payment from the United Kingdom of a tax credit equal to one-half of the tax credit to which an individual resident in the United Kingdom would have been entitled had he received the dividend . . ."

Article 23(1)(c)

> ". . . . For the purposes of applying the United States credit in relation to tax paid to the United Kingdom:
>
> . . . that amount of tax credit referred to in paragraph (2)(a)(i) of Article 10 (Dividends) which is not paid to the United States corporation but to which an individual resident in the United Kingdom would have been entitled had he received the dividend shall be treated as an

> income tax imposed on the corporation paying the dividend."

The "tax credit" referred to above is, as plaintiff asserts, the section 86 U.K. shareholder credit. However, a credit against U.K. tax liability is not what the foregoing articles confer upon a U.S. shareholder. Article 10(2)(a)(i) provides that a U.S. direct investor receive a "payment" from the U.K. "equal to one-half of the tax credit" a U.K. resident would receive. Moreover, Article 23(1) specifically provides that a U.S. direct investor be allowed a U.S. tax credit "for the appropriate amount of tax paid (emphasis added) to the United Kingdom" on account of the dividend distribution. The Article 23(1)(c) credit is qualified as a U.S. credit applied "in relation to tax paid to the United Kingdom."

Thus, the treaty language cited by plaintiff hardly affirms its theory that the applicability of an Article 23(1)(c) U.S. foreign tax credit is entirely independent of the ACT paid by its U.K. subsidiar(ies). To better determine the intent of the treaty parties with respect to the applicability of the Article 23(1)(c) credit, it is appropriate to examine the official pronouncements of the United States (and the United Kingdom) in connection with the ratification and implementation of the Convention. *Air France v. Saks*, 470 U.S. 392, 396, 105 S.Ct. 1338, 84 L.Ed.2d 289 (1985); "[T]reaties are construed more liberally than private agreements, and to ascertain their meaning we may look beyond the written words to the history of the treaty, the negotiations, and the practical construction adopted by the parties." (quoting *Choctaw Nation of Indians v. United States*, 318 U.S. 423, 431-32 (1943)).

The Technical Explanation

After the signing of the US-UK Income Tax Treaty on December 31, 1975, a "Technical Explanation" was prepared by the U.S. Department of the Treasury in connection with the submission of the Convention to the Senate for hearings on ratification in 1977. The Technical Explanation, which provided an article by article interpretation of the Convention, stated the following with respect to ACT in the context of Article 23:

> "ACT which reduces mainstream [corporation] tax in any year or years shall be attributable to any accumulated profits of the year or years for which the mainstream tax is reduced. Where ACT is used to offset mainstream tax, the offset will be viewed as a refund of the ACT initially allowed as a credit and as a tax paid in respect of the year for which the ACT is applied as an offset. Consequently, a reduction in the foreign tax credit for the year from which the ACT is carried must be made in accordance with section 905(c) of the Code."

This explanation accords with defendant's view that the Article 23(1)(c) U.S. foreign tax credit is linked to the payment of ACT and the year of its application as an offset against U.K. corporation tax liability. It refutes plaintiff's first two arguments that ACT and offset considerations are unconnected to the Article 23(1)(c) credit.

The Technical Explanation reveals the intent of Treasury with respect to the Convention and, as numerous federal courts have stated, "the meaning attributed to treaty provisions by the Government agencies charged with their negotiation and enforce-

ment is entitled to great weight." *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176, 194, 102 S.Ct. 2374, 72 L.Ed.2d 765 (1982); *See also Kolovrat v. Oregon*, 366 U.S. 187, 194, 81 S.Ct. 922, 6 L.Ed.2d 218 (1961); *Great-West Life Assurance Co. v. United States*, 230 Ct. Cl. 477, 491, 678 F.2d 180, 189 (1982). Moreover, the Senate's consideration of the Convention, beginning in July 1977, was based upon the interpretation set forth in the Technical Explanation. Hearings and floor debates were held, following which the Senate intially rejected the treaty before approving it with two reservations in June 1978. The Convention was ratified by the Senate in its final form on July 9, 1979. The record does not indicate any disagreement in the Senate during this time concerning the interpretation of Article 23 in the Technical Explanation, or any proposals for reservations in regard thereto. At most, the Senate Committee on Foreign Relations, in recommending ratification of the Convention, acknowledged Treasury's discretionary authority in the future administration of the Article 23 provisions.[3] Accordingly, it is logical to conclude that the Senate was in accord with Treasury's interpretation of Article 23 as set forth in the Technical Explanation when it ratified the US-UK Income Tax Treaty in 1978-79.

Similarly, the record indicates at least tacit acceptance by the U.K. of the U.S. interpretation of Article

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[3] "[I]n recommending the ratification of the treaty, the Committee does not intend to adopt or reject the amplifications of the foreign tax credit rules contained in the Treasury technical explanation. Consequently, Treasury would not be foreclosed by the ratification of the Treaty from modifying those administrative interpretations in the future should it deem it advisable to do so. S. Exec. Rep. 18 at 36-37, reprinted in 1980-81 Cum. Bull. at 429.

23(1)(c) as set forth in the Technical Explanation. As stated in the affidavit of Steven P. Hannes, who was a member of the U.S. negotiating team in 1975 and an attorney for Treasury during the U.S. Senate's consideration of the treaty, "copies of the Technical Explanation would have been sent to the U.K. negotiators." [4] Knowledge of the U.S. interpretation, therefore, was clearly before the House of Commons during its own ratification debate. The U.K. ratified the Convention in the form approved by the U.S. Senate, without further reservation or amendment, by enacting section 16 of the Finance Act (No. 2) 1979, dated July 26, 1979.

Revenue Procedure 80-18

On April 25, 1980, the day the US-UK Income Tax Treaty took effect, the Internal Revenue Service issued Revenue Procedure (Rev. Proc.) 80-18 setting forth procedures for U.S. taxpayers to follow under the applicable provisions of Articles 10 and 23. Section 3.05 of Rev. Proc. 80-18 described the tax ramifications of Article 21(1)(c), in pertinent part, as follows:

> Paragraph (1)(c) of Article 23 provides, in addition, that the one-half of the ACT paid by a United Kingdom corporation that is not refunded to a U.S. direct investor [pursuant to Article 10] and that would be credited or refunded to a United Kingdom individual resident is treated as an income tax imposed on the distributing United Kingdom corporation (rather than the U.S. shareholder). Under United King-

[4] Plaintiff's Exhibit 30, Affidavit of Steven P. Hannes, pp. 7-8.

> dom law, a United Kingdom corporation that pays ACT may, however, transfer to a related United Kingdom corporation the right to apply ACT against mainstream tax liability. Thus, for example, a United Kingdom subsidiary of a United Kingdom corporation may benefit from the parent's ACT payment by offsetting part or all of the ACT against its own liability for United Kingdom mainstream tax. *In such a case, for U.S. foreign tax credit purposes and pursuant to Article 23, the parent corporation has not paid or accrued the unrefunded ACT offset against the subsidiary's mainstream tax and has contributed to the capital of the subsidiary an amount equal to the unrefunded ACT offset. The subsidiary is considered to have paid or accrued only mainstream tax paid or accrued in excess of the ACT offset, plus the amount of unrefunded ACT so offset.* (Emphasis added.)

This revenue ruling, augmenting the treaty interpretation outlined in the Technical Explanation, fully-accords with defendant's position on Article 23 (1)(c). All three of plaintiff's arguments conflict with Rev. Proc. 80-18.

Competent Authority Agreement

Notwithstanding the foregoing authority, Xerox and other U.S. "direct investors" in U.K. corporations continued to express doubts about the U.S. government's interpretation of Article 23(1). To resolve this ongoing dispute, the "competent authorities" of the United States and the United Kingdom entered into negotiations in accordance with the Convention's Article 25 "Mutual Agreement Procedure." This article provides, in pertinent part, as follows:

ARTICLE 25—MUTUAL AGREEMENT PROCEDURE

. . . .

(3) The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. In particular the competent authorities of the Contracting States may reach agreement on:

(a) the attribution of income, deductions, credits, or allowances of an enterprise of a Contracting State to its permanent establishment situated in the other Contracting State;

(b) the allocation of income, deductions, credits, or allowances between persons;

(c) the nature of particular items of income;

(d) the meaning of terms not otherwise defined in this Convention;

(e) the place where a particular item of income has it source.

(4) The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching agreement as contemplated by this Convention.[5]

After several years of correspondence and meetings between the U.S. and U.K. competent authorities, an agreement emerged in December 1986. This

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[5] The United States Competent Authority, as delegated by the Secretary of the Treasury, is the Associate Commissioner (Operations) of the Internal Revenue Service.

agreement took the form of an exchange of letters which read as follows:

December 18, 1986

Mr. P.W. Fawcett
Inland Revenue, Policy Division
Room F-14, West Wing
Somerset House
London, WC2R 1LB
England

Dear Mr. Fawcett:

The following memorializes the agreement reached at our meetings of July 11, and September 12, 1986, and *is intended to constitute, when accepted by you, a competent authority agreement under Article 25 of the Convention* between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to Taxes on Income (the "Convention"). (Emphasis added.)

1. *It is agreed that Article 23(1)(c) provides a mechanism by which a U.S. foreign tax credit may be obtained for that part of the U.K. tax credit referred to in Article 10(2)(a)(i) which is not paid to a U.S. corporation* but to which an individual resident in the United Kingdom would have been entitled had he received the dividend. (Emphasis added.)

2. *It is agreed that Article 23(1)(c) was included in the Convention for the purpose of ensuring that in accordance with Article 23(1)(a)*

the Advance Corporation Tax ("ACT") payment which generally underlies the U.K. tax credit referred to in paragraph 1 *would be treated as an income tax paid to the United Kingdom by the U.K. corporation paying the dividend,* because the United States questioned to what extent, in the absence of the Convention, payments of ACT would be treated as payments of a creditable corporate income tax for U.S. foreign tax credit purposes. (Emphasis added.)

3. *It is agreed that, pursuant to Article 23 (1), the Article 23(1)(c) mechanism must be applied in accordance with* the provisions and subject to the limitations of *the law of the United States and that a credit is to be given under Article 23(1)(c) only for the appropriate amount of tax paid to the United Kingdom.* (Emphasis added).

4. *It is agreed that Article 23(1) of the Convention was not intended to provide two U.S. foreign tax credits for a single payment of ACT to the United Kingdom* or U.S. foreign tax credits in excess of the amount of corporation tax (including both ACT and mainstream corporation tax) paid to the United Kingdom in respect of the profits out which a dividend is paid. (Emphasis added.)

5. *It is agreed that under the language of Article 23(1)* which provides that the Article 23 (1)(c) credit must be allowed in accordance with the provisions and subject to the limitations of the law of the United States, *the timing of the credit is to be determined as a matter of U.S. law.* (Emphasis added.)

I would appreciate your reply as to whether you are in agreement with the propositions set forth in paragraphs (1) through (5) above. If you do assent to these propositions, we will consider such propositions to be a competent authority agreement under Article 25 of the Convention. *This agreement will supercede any and all prior agreements or correspondence between us regarding the matters addressed herein.* (Emphasis added.)

Sincerely,

/s/

P.E. Coates
[U.S. Competent Authority]

Mr. P.E. Coates
Associate Commissioner (Operations)
Internal Revenue Service
Department of the Treasury
Washington, DC 20224
USA

23 December 1986

Dear Mr. Coates:

Thank you for your letter of 18 December 1986 recording the agreements reached at our meetings on 11 July and 12 September 1986.

I am writing to say that *I am in agreement with the propositions set out in paragraphs 1 to 5* of your letter, and *your letter and this letter now constitute a competent authority agreement* under Article 25 of the UK/US Double Taxation Convention, *superseding previous correspondence*

between us on the matters covered in the letters. (Emphasis added.)

Yours sincerely,

/s/
P.W. Fawcett
[U.K. Competent Authority]

This "Competent Authority Agreement" further supports defendant's position that the Article 23 (1) (c) U.S. foreign tax credit is linked to the payment of ACT rather than the preceding dividend distribution by the U.K. corporation. It affirms that both treaty parties view the application of the Article 23(1)(c) credit as a matter of U.S. law, thereby undermining plaintiff's argument that this credit is based on the shareholder credit of U.K. law (section 86, FA 1972), which arises as the direct consequence of a dividend distribution by a U.K. corporation without regard to whether ACT is paid thereon. Moreover, the agreement of the competent authorities as to the governance of U.S. law over the timing of the Article 23(1)(c) credit accords with defendant's view, previously expressed in the Technical Explanation and Rev. Proc. 80-18, that the credit must ultimately be applied in the year the underlying ACT is used to offset U.K. corporation tax liability.

* * * *

Plaintiff challenges the authoritativeness of the foregoing official pronouncements with respect to the proper interpretation of Article 23(1)(c). The Technical Explanation is characterized by plaintiff as a

vehicle by which Treasury attempted not just to explain the treaty's contents, but "to legislate its changing views of what it believes should have been added to the treaty." [6] Plaintiff charges that Rev. Proc. 80-18, in its explanation of the U.S. foreign tax credit consequences of an ACT surender, misconstrues both U.S. law and the terms of the treaty and is therefore "invalid." [7] As for the Competent Authority Agreement, plaintiff asserts that it is weak on content—a collection of "self-evident and noncontroversial statements which are more consistent with plaintiff's position than defendant's." [8] More importantly, acording to plaintiff, neither the Competent Authority Agreement nor the Technical Explanation addresses the central issue in this case—the significance for Xerox of RXL's surrender of section 85 ACT offsets. Accordingly, plaintiff maintains that none of these materials provides a reliable guide as to the intent of the treaty parties. Thus, they should not be accorded much evidentiary weight in this action.

The court, however, does not share plaintiff's dim view of these documents. As previously discussed, Treasury's Technical Explanation was presented to the U.S. Senate as an aid to its understanding of the treaty articles, and the Senate's intent in ratifying the Convention was clearly shaped thereby. In view of the United Kingdom's subsequent ratification of the Convention without reservation, and with full knowledge of the Technical Explanation underlying the U.S. ratification, it is difficult to sustain plain-

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[6] Pretrial Reply Brief of Plaintiff, p. 30.

[7] Pretrial Brief of Plaintiff, pp. 43-47.

[8] Pretrial Reply Brief of Plaintiff, p. 25.

tiff's assertion that the Technical Explanation did not conform with the terms of the treaty. Moreover, plaintiff can hardly minimize the importance of the Competent Authority Agreement as an expression of the intent of the treaty parties, since Article 25(3) of the Convention specifically empowered the competent authorities "to resolve . . . any difficulties or doubts arising as to the interpretation or application of the Convention." Courts have traditionally been reluctant to impinge on the judgments of competent authorities charged by the treaty states with responsibilities of interpretation and implementation. *Sumitomo Shoji American, Inc. v. Avagliano*, 457 U.S. 176, 185, 102 S.Ct. 2374, 72 L.Ed.2d 765 (1982); *Filler v. Commisioner*, 74 T.C. 406, 408-09 (1980); *See also Collins v. Weinberger*, 707 F.2d 1518, 1522-1523 (D.C. Cir. 1983). As the Supreme Court stated in *Sumitomo*, 457 U.S. at 185, "Our role is limited to giving effect to the intent of the Treaty parties. When the parties to a treaty both agree as to the meaning of a treaty provision, and that interpretation follows from the clear treaty language, we must, absent extraordinarily strong contrary evidence, defer to that interpretation."

This court finds no such "extraordinarily strong contrary evidence" in the case at bar, to the effect that the Competent Authority Agreement misinterprets the language of the Convention or the intent of the treaty parties. Nor does the court find this Agreement a relatively substance-less document generally favorable, as plaintiff alleges, to its position. To the contrary, as previously discussed, the court finds the Competent Authority Agreement strongly supportive of defendant's position on Article 23 (1)(c). Moreover, the court finds this Agreement,

along with the Technical Explanation and Rev. Proc. 80-18, fully in accordance with the language of Article 23(1) tying the U.S. tax credit under Article 23(1)(c) not just to a dividend distribution, but "to tax paid to the United Kingdom."

Plaintiff's assertion that the Competent Authority Agreement and the Technical Explanation fail to address the ACT surrender issue is specious. While the word "surrender" may not appear in the texts, that action is clearly covered in previously cited passages from these documents. Thus, the Technical Explanation states with respect to Article 23:

> "Where ACT is used to offset mainstream tax, the offset will be viewed as a refund of the ACT initially allowed as a credit and as a tax paid in respect of the year for which the ACT is applied as an offset."

And the Competent Authority Agreement states in paragraph 5:

> "It is agreed that under the language of Article 23(1) . . . the timing of the credit is to be determined as a matter of U.S. law."

These pasages present the scenario of the U.S. tax credit arising in a different year from that of the ACT payment, which would happen when either the original payor of ACT *or* its subsidiar(ies), as *surrenderee(s)*, apply the ACT offset against U.K. mainstream tax liability in a year other than that of the dividend distribution.

Plaintiff contends that Rev. Proc. 80-18 is out of step with U.S. tax law and the language of Article 23(1)(c). In particular, plaintiff argues that RXL was the "technical taxpayer" of the ACT for U.S. foreign tax credit purposes under the principles set

forth by the Supreme Court in *Biddle v. Commissioner*, 302 U.S. 573, 579-81, 58 S. Ct. 379, 82 L.Ed. 431 (1938). Rev. Proc. 80-18, plaintiff asserts, is in direct conflict with the *Biddle* decision. Plaintiff also cites Treasury Reg. § 1.901-2(f), issued in 1983, which defines "taxpayer" for foreign tax credit purposes as "the person on whom foreign law imposes legal liability for such tax." According to plaintiff, language in Rev. Proc. 80-18 to the effect that, after a U.K. corporation's payment of ACT and surrender of the offset to a subsidiary who applies it against U.K. corporation tax, "for U.S. foreign tax credit purposes and pursuant to Article 23, the parent corporation has not paid or accrued the unrefunded ACT offset against the subsidiary's mainstream tax" cannot be reconciled with U.S. tax law.

The above language, however, addresses the potential problem of double crediting for a single payment of ACT. As defendant points out, Article 23(1)(c) treats the corporation paying ACT as having paid an income tax for U.S. tax purposes, while Article 23(1)(a) also treats the surrenderee of the offset who applies it against its own corporation tax liability as having paid the ACT for U.S. tax purposes. To forestall any double credit, Rev. Proc. 80-18 treats the original Article 23(1)(c) credit as reversed in favor of an Article 23(1)(a) credit whereby "the subsidiary is considered to have paid or accrued only mainstream tax paid or accrued in excess of the ACT offset, plus the amount of unrefunded ACT so offset." This ruling accords with the body of U.S. law holding that double crediting is to be avoided unless expressly anticipated or provided for by Congress. *Cleveland Electric Illuminating Co. v. United States*, 6 Cl. Ct. 711, 715 (1984); *National Cash Register Co. v. United States*, 400 F.2d 820,

825-26 (6th Cir. 1968). Moreover, Rev. Proc. 80-18 was expressly affirmed in the subsequent Competent Authority Agreement which stated that "Article 23(1) of the Convention was not intended to provide two U.S. foreign tax credits for a single payment of ACT to the United Kingdom." 1986 Competent Authority Agreement, ¶ 4, *supra.*

Authority for this reversal of the Article 23(1)(c) credit when ACT is surendered can also be found in section 905(c) of the Internal Revenue Code, which requires a recomputation of the U.S. indirect foreign tax credit when foreign taxes are refunded. As previously noted, the Technical Explanation which formed the basis of the Senate's understanding of the Convention and which was tacitly accepted by the U.K. prior to its own ratification, stated specifically that "Where ACT is used to offset mainstream tax, the offset will be viewed as a *refund* of the ACT initially allowed as a credit," necessitating "a *reduction* in the foreign tax credit for the year [the ACT was initially paid] . . . in accordance with section 905(c) of the Code." (Emphasis added.) This language, in confirming the applicability of section 905(c) in determining entitlement to a U.S. foreign tax credit under the Convention, manifests the interim nature of the Article 23(1)(c) credit.

With the reversal of the initial credit arising with the payment of ACT, Article 23(1)(a) remains the only avenue to claim a credit for the ACT. The credit shifts to the year(s) the ACT is applied against "mainstream" (corporation) tax and is viewed "as a tax paid in respect of [that] year." 1977 Technical Explanation, *supra.* Based on this language in the Technical Explanation, Rev. Proc. 80-18 duly recognizes that the "tax paid" by a subsidiary (as surrenderee) applying the ACT offset is

"the amount of the unrefunded ACT." While plaintiff objects to this interpretation not only shifting the credit mechanism from Article 23(1)(c) to Article 23(1)(a) but also making the surrenderee the deemed payor of the ACT, the court does not find the interpretation unreasonable in view of the fact that the *surrenderee's* U.K. tax liability is satisfied.

In this respect the court finds the case at bar distinguishable from *Biddle, supra.* In that case plaintiff, a U.S. national who received cash dividends on stock held in three U.K. corporations, claimed U.S. foreign tax credits based on the U.K. income taxes assessed against the U.K. corporations with respect to the profits out of which the dividends were distributed. The Supreme Court, noting that Biddle had no independent U.K. tax liability and received his dividends only after the U.K. corporations had been taxed upon their earnings, held that Biddle could not be considered the taxpayer of any U.K. income taxes for U.S. foreign tax credit purposes. In the case at bar, RXM, RX-UK, and RX-Ireland did have their own U.K. corporation tax liabilities which were satisfied, at least in part, by the application of the ACT offsets received from RXL. The surrenderees were certainly "the person[s] on whom foreign law imposes legal liability for such [corporation] tax[es]" within the meaning of Treasury Reg. § 1.901-2(f), *supra,* unlike Biddle who had no such liability with regard to U.K. income taxes on the earnings from which his dividends were distributed. Moreover, treating the surrenderees as the deemed payors of ACT when they apply the offsets against U.K. corporation tax liability furthers the expressed purpose of both treaty parties to prevent a double U.S. tax credit for a single payment of ACT.

Accordingly, the court rejects plaintiff's contention that Rev. Proc. 80-18 is "invalid" insofar as it treats the surrenderee as the deemed taxpayer of ACT for U.S. foreign tax credit purposes. Nor does the court find any relevance in plaintiff's companion argument that a surrenderee cannot be considered the "corporation paying the dividend" under Article 23(1)(c) of the treaty, since a surrenderee applies the ACT offset against U.K. tax liability under Article 23(1)(a) and not as the "corporation paying the dividend" under Article 23(1)(c). Thus, the court finds the theories advanced by plaintiff in its third line of reasoning (p. 13, *supra*) unpersuasive.

* * * *

At trial, plaintiff elicited testimony from various experts on U.K. tax law concerning the U.K. imputation system and certain aspects of the US-UK Income Tax Treaty.[9] Plaintiff also introduced affidavits from two former members of the U.S. negotiating team containing their views as to the intent of the U.S. and U.K. treaty negotiators in 1975 and brief comments on the Technical Explanation, as well as internal U.S. government memoranda summarizing meetings held at Treasury in 1977, to discuss the Technical Explanation,[10] and at IRS in 1980, to dis-

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[9] Over defendant's objection, the court also heard testimony under an offer of proof pursuant to Rule 103(a)(2) of the Federal Rules of Evidence regarding alleged misstatements of U.K. law in parts of the Technical Explanation covering Articles 10 and 23 of the Convention. The court admits this testimony into evidence to be accorded its due weight.

[10] Plaintiff's Exhibits 28 and 29, Affidavits of Robert J. Patrick, Jr.; Plaintiff's Exhibit 30, Affidavit of Steven P. Hannes.

cuss Rev. Proc. 80-18.[11] The court concludes, however, that the foregoing items are entitled to little evidentiary weight in this action.

The Patrick and Hannes affidavits, statements of former U.S. government agents involved in the negotiations, cannot, in this court's judgment, take precedence over the Technical Explanation and other official pronouncements of the United States and the United Kingdom as evidence of the intent of the treaty parties. To the extent the affidavits and the official pronouncements are inconsistent, the affidavits must give way. *See generally Coplin v. United States*, 6 Cl. Ct. 115, 128 (1984), rev'd on other grounds, 761 F.2d 688 (Fed. Cir. 1985) aff'd, sub nom., *O'Connor v. United States*, 479 U.S. ——, 107 S. Ct. 347, 93 L.Ed.2d 206 (1986); *Johnson Controls, Inc. v. United States*, 8 Cl. Ct. 359, 370 (1985). This same reasoning applies to the internal U.S. government memoranda, which will not be accorded greater weight than the official U.S. government pronouncements which were issued thereafter. In short, plaintiff has failed to convince this court that there is sufficient ambiguity in the treaty language and associated official pronouncements necessitating our resort to the foregoing evidence as a means of construing the intent of the treaty parties.

The testimony of plaintiff's witnesses, while very illuminating as to U.K. law, is of little assistance to the court in interpreting Articles 10 and 23 of the US-UK Income Tax Treaty. Principles of U.K. tax law were not incorporated into treaty Articles 10 and 23 and did not underlie the U.S. Senate's understanding of the Convention in the ratification process.

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[11] Plaintiff's Exhibit 31.

Moreover, the Competent Authority Agreement expressly confirmed that the application and timing of the Article 23(1)(c) tax credit was a matter of U.S. law. The testimony received by the court under offer of proof, concerning alleged misstatements of U.K. law in the Technical Explanation, is likewise unavailing to plaintiff's cause. The Technical Explanation formed the basis of the Senate's intent in ratifying the Convention, and no objection thereto was voiced by the U.K. prior to its own ratification. Regardless of the accuracy of the Technical Explanation in describing U.K. law, it is clear that this document, not U.K. law, is determinative of the intent of the treaty parties.

CONCLUSION

For the reasons discussed herein, the court finds that plaintiff has not established its entitlement to the indirect foreign tax credit for 1974 claimed under Article 23(1)(c) of the US-UK Income Tax Treaty. Having determined that there is no just reason for delay, the Court hereby directs the Clerk to enter judgment dismissing that part of the complaint seeking a refund of federal income taxes in the amount of $1,826,222.

With respect to plaintiff's other causes of action, the parties shall advise the court within 60 days as to their plans for further proceedings.

No costs.

IT IS SO ORDERED.

/s/ Bohdan A. Futey
BOHDAN A. FUTEY
Judge

APPENDIX E

IN THE
UNITED STATES COURT OF FEDERAL CLAIMS

No. 80-85T

(Filed January 5, 1993)

XEROX CORPORATION, PLAINTIFF

v.

THE UNITED STATES, DEFENDANT

ORDER

This matter is before the court on plaintiff's motion filed on November 9, 1992, for reconsideration of the Opinion issued March 17, 1988.[1] On December 10, 1992, defendant filed its response. Although not required by the RCFC, the court will allow plaintiff's motion for leave to file a reply brief as of this date.

After careful consideration, however, this court finds no grounds upon which to grant the motion for reconsideration. Moreover, the case cited by plaintiff, *Snap-on-Tools, Inc. v. United States*, 26 Cl. Ct. 1045 (1992) is not binding precedent. *See Sun Eagle Corp. v. United States*, 23 Cl. Ct. 465, 473 (1991).

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[1] Although the Opinion was issued on March 17, 1988, judgment was entered on November 5, 1992.

Accordingly, this court stands by its Opinion issued over 4 years ago. Plaintiff's motion for reconsideration is DENIED.

IT IS SO ORDERED.

/s/ Bohdan A. Futey
BOHDAN A. FUTEY
Judge

APPENDIX F

STATUTORY, TREATY AND REGULATORY PROVISIONS

1. The Internal Revenue Code of 1954, as in effect for the year 1974, provided in relevant part:

a. 26 U.S.C. 901. TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES.

(a) *Allowance of Credit.*

If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the applicable limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under sections 902 and 960. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year. The credit shall not be allowed against the tax imposed by section 56 (relating to minimum tax for tax preferences), against the tax imposed by section 531 (relating to the tax on accumulated earnings), against the additional tax imposed for the taxable year under section 1333 (relating to war loss recoveries) or under section 1351 (relating to recoveries of foreign expropriation losses) or against the personal holding company tax imposed by section 541.

(b) *Amount Allowed.*

Subject to the applicable limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

(1) *Citizens and domestic corporations.*—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

* * * * *

b. 26 U.S.C. CREDIT FOR CORPORATION STOCKHOLDER IN FOREIGN CORPORATIONS.

(a) *Treatment of Taxes Paid by Foreign Corporation.*—For purposes of the subpart, a domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall—

(1) to the extent such dividends are paid by such foreign corporation out of accumulated profits (as defined in subsection (c)(1)(A)) of a year for which such foreign corporation is not a less developed country corporation, be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States on or with respect to such accumulated profits, which the amount of such dividends (determined without regard to section 78) bears to the amount of such accumulated

profits in excess of such income, war profits, and excess profits taxes (other than those deemed paid); and

* * * * *

(b) *Foreign Subsidiary of First and Second Foreign Corporation.*—

(1) If the foreign corporation described in subsection (a) (hereinafter in this subsection referred to as the "first foreign corporation") owns 10 percent or more of the voting stock of a second foreign corporation from which it receives dividends in any taxable year, it shall be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such second foreign corporation to any foreign country or to any possession of the United States on or with respect to the accumulated profits of the corporation from which such dividends were paid which—

(A) for purposes of applying subsection (a)(1), the amount of such dividends bears to the amount of the accumulated profits (as defined in subsection (c)(1)(A)) of such second foreign corporation from which such dividends were paid in excess of such income, war profits, and excess profits taxes, or

* * * * *

(2) If such first foreign corporation owns 10 percent or more of the voting stock of a second foreign corporation which, in turn, owns 10 percent or more of the voting stock of a third foreign corporation from which the second foreign corporation receives dividends in any taxable

year, the second foreign corporation shall be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid by such third foreign corporation to any foreign country or to any possession of the United States on or with respect to the accumulated profits of the corporation from which such dividends were paid which—

(A) for purposes of applying subsection (a)(1), the amount of such dividends bears to the amount of the accumulated profits (as defined in subsection (c)(1)(A) of such third foreign corporation from which such dividends were paid in excess of such income, war profits, and excess profits taxes, or

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c. 26 U.S.C. 905 APPLICABLE RULES

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(c) *Adjustments on Payment of Accrued Taxes.*— If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the Secretary or his delegate, who shall redetermine the amount of the tax for the year or years affected. The amount of tax due on such redetermination, if any, shall be paid by the taxpayer on notice and demand by the Secretary or his delegate, or the amount of tax overpaid, if any shall be credited or refunded to the taxpayer in accordance with subchapter B of chapter 66 (sec. 6511 and following). * * *.

* * * * *

2. The Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Tax on Income and Capital Gains, T.I.A.S. No. 9682, 31 U.S.T. 5668, provides in relevant part:

Article 2—Taxes Covered

* * * * *

(2) The existing taxes to which the Convention shall apply are:

* * * * *

(b) in the case of the United Kingdom, the income tax, the capital gains tax, the corporation tax and the petroleum revenue tax. The foregoing taxes covered are hereinafter referred to as "United Kingdom tax."

* * * * *

Article 10—Dividends

* * * * *

(2)

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(a) In the case of dividends paid by a corporation which is a resident of the United Kingdom:

(i) to a United States corporation which either alone or together with one or more associated corporations controls, directly or indirectly, at least 10 percent of the voting stock of the corporation which is a resident of the United Kingdom paying the dividend, the United States corporation shall be entitled to a payment from the

United Kingdom of a tax credit equal to one-half of the tax credit to which an individual resident in the United Kingdom would have been entitled had he received the dividend, subject to the deduction withheld from such payment and according to the laws of the United Kingdom of an amount not exceeding 5 percent of the aggregate of the amount or value of the dividend and the amount of the tax credit paid to such corporation;

* * * * *

Article 23—Elimination of Double Taxation

(1) In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or national of the United States as a credit against the United States tax the appropriate amount of tax paid to the United Kingdom; and, in the case of a United States corporation owning at least 10 percent of the voting stock of a corporation which is a resident of the United Kingdom from which it receives dividends in any taxable year, the United States shall allow credit for the appropriate amount of tax paid to the United Kingdom by that corporation with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid to the United Kingdom, but the credit shall not exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources outside of the United States) provided by United States law for the taxable year. For the pur-

poses of applying the United States credit in relation to tax paid to the United Kingdom:

(a) the taxes referred to in paragraphs (2) (b) and (3) of Article 2 (Taxes Covered) shall be considered to be income taxes;

(b) the amount of 5 or 15 percent, as the case may be, withheld under paragraph (2) (a) (i) or (ii) of Article 10 (Dividends) from the tax credit paid by the United Kingdom shall be treated as an income tax imposed on the recipient of the dividend; and

(c) that amount of tax credit referred to in paragraph (2) (a) (i) of Article 10 (Dividends) which is not paid to the United States corporation but to which an individual resident in the United Kingdom would have been entitled had he received the dividend shall be treated as an income tax imposed on the United Kingdom corporation paying the dividend.

* * * * *

3. Technical Explanation of the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Tax on Income and Capital Gains, 1980-1 C.B. 455, provides in relevant part:

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Article 23. Elimination of Double Taxation

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In the United Kingdom tax system, ACT serves a dual function. To the extent that it offsets the United Kingdom corporate income tax imposed with-

out regard to distributions (hereinafter referred to as "mainstream tax"), it is analogous to a payment of regular corporate income tax. To the extent that it does not offset mainstream tax, it is more analogous to a tax imposed on distributions which are income to shareholders.

To reflect this hybrid nature of ACT, ACT which offsets mainstream tax will be attributed to the earnings of the year in which it offsets such tax and treated as if it were regular corporate tax. ACT which does not offset mainstream tax will generally be attributed to the accumulated profits of the year of distribution.

* * * * *

ACT which reduces mainstream tax in any year or years shall be attributable to any accumulated profits of the year or years for which the mainstream tax is reduced. Where ACT is used to offset mainstream tax, the offset will be viewed as a refund of the ACT initially allowed as a credit and as a tax paid in respect of the year for which the ACT is applied as an offset. Consequently, a reduction in the foreign tax credit for the year from which the ACT is carried must be made in accordance with section 905(c) of the Code.

4. Revenue Procedure 80-18, 1980-1 C.B. 623, provides in relevant part:

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Sec. 3. Application of ACT Refunds to United States Shareholders

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.05 *Allowance of Foreign Tax Credits with Respect to ACT Refunds.*

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Paragraph (1)(c) of Article 23 provides, in addition, that the one-half of the ACT paid by a United Kingdom corporation that is not refunded to a U.S. direct investor and that would be credited or refunded to a United Kingdom individual resident is treated as an income tax imposed on the distributing United Kingdom corporation (rather than the U.S. shareholder). Under United Kingdom law, a United Kingdom corporation that pays ACT may, however, transfer to a related United Kingdom corporation the right to apply ACT against mainstream tax liability. Thus, for example, a United Kingdom subsidiary of a United Kingdom corporation may benefit from the parent's ACT payment by offsetting part or all of the ACT against its own liability for United Kingdom mainstream tax. In such a case, for U.S. foreign tax credit purposes and pursuant to Article 23, the parent corporation has not paid or accrued the unrefunded ACT offset against the subsidiary's mainstream tax and has contributed to the capital of the subsidiary an amount equal to the unrefunded ACT offset. The subsidiary is considered to have paid or accrued only mainstream tax paid or accrued in excess of the ACT offset, plus the amount of unrefunded ACT so offset.

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